Government of Canada

Tax Expenditures

December 1994

Canada

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Department of Finance Canada
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Introduction

The purpose of this report is to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada's federal income tax system and the Goods and Services Tax (GST). It is also an important input into the process of evaluating the operation of these tax systems. However, it should be emphasized that this report itself does not attempt to make judgements about either the appropriateness of government policy objectives or the effectiveness of the various tax provisions in achieving those objectives.

The principal function of taxes is to raise the revenues necessary to finance government operations. In addition, tax measures are often used to implement government policy objectives by providing assistance or incentives to particular groups of individuals, businesses or to certain types of activities. These measures, which can take the form of tax exemptions, deductions, deferrals or credits, are typically referred to as tax expenditures. This document provides estimates of the cost of these items for the personal income tax system for the years 1991 and 1992, and the corporate income tax system for the years 1990 and 1991. It also provides estimates of the costs of tax expenditures associated with the GST for the years 1991 and 1992, the first two years of operation of the tax.

In order to identify tax expenditures, it is necessary to establish a "benchmark" tax structure which does not contain any preferential tax provisions. Tax expenditures are then defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the definition of the benchmark tax system, and hence what constitutes a tax expenditure. For example, child care expenses could be considered to be a cost of earning income and therefore part of the benchmark tax system but, if they are regarded as personal consumption, then tax assistance for child care expenses would be a tax expenditure.

This report takes a broad approach – only the most fundamental structural elements of each tax system are considered to be part of the benchmark. By defining the benchmark in this manner, many tax provisions are treated as tax expenditures. This approach provides information on a full range of measures, and so allows readers who take a different position as to the appropriate benchmark system to construct their own list of tax expenditures.

There are several tax provisions identified in the document that are not generally considered to be tax expenditures even though they reduce the amount of revenue collected. These measures are denoted as "memorandum items" and have been included to provide additional information. Three types of memorandum item are included.

- Measures that are considered to be part of the benchmark system. The dividend tax credit, for example, reduces or eliminates the double taxation of income earned by corporations and distributed to individuals through dividends.

- Measures where there may be some debate over whether the item should be considered to be a tax expenditure. The cost of business-related meals and entertainment, for example, may be considered to be an expense incurred in order to earn income (and therefore part of the benchmark) or may be considered to provide a significant element of personal benefit (and therefore constitute a tax expenditure).
- Measures where the available data do not permit separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. For example, a portion of tax free allowances for MPs is used to cover legitimate employment expenses (and is therefore part of the benchmark for the income tax system) while the rest may be used for personal consumption (and is therefore an income tax expenditure). Since it is not possible to distinguish between these two elements, the non-taxation of such allowances is included as a memorandum item.

The federal government collects personal income taxes on behalf of the provinces (other than Quebec) which levy their income taxes as a percentage of basic federal tax. It also collects corporate income taxes on behalf of seven provinces (the exceptions are Quebec, Ontario, and Alberta), which use the same taxable income base as the federal government but levy taxes at their own rates. While there are provincial costs associated with the income tax measures examined in this report, the estimates do not incorporate these effects.

Similarly, changes in the GST base can affect provincial revenues. For example, the Atlantic provinces and Quebec levy their sales taxes on a base which includes the GST. In addition, since July 1992, Quebec has substantially harmonized its tax base with the GST. However, changes in the federal tax base would not affect Quebec revenues without a specific change in provincial legislation. As with the income tax measures, the estimates for the GST tax expenditures in this report reflect only federal impacts.

Tax expenditure documents published prior to tax reform provided estimates for personal, corporate and commodity taxes. Phase one of tax reform came into effect in 1988, resulting in a major overhaul of the personal and corporate income tax systems. Many tax expenditures were eliminated, reduced, or, in the case of personal taxes, changed from deductions to credits. Tax reform affected not only the number of tax expenditures, but also their revenue impacts because it changed the rate structure against which they are calculated. The second phase of tax reform replaced the manufacturers' sales tax with the GST, effective January 1, 1991. Because of the significant changes in the tax structure throughout these reforms, no estimates were released during this transitional period.

In December 1992, the first post-reform report, *Government of Canada Personal Income Tax Expenditures*, was issued. This report covered only personal income tax expenditures for the years 1988 and 1989 because of the lack of statistical information on the newly introduced GST and lags in

the receipt of post-1988 tax reform data for corporations. While preliminary post-reform data for the 1988 taxation year were available for corporations, they did not accurately reflect the impact of tax reform because of the transitional measures in the package and the carry-over of accelerated deductions and credits from previous years.

In December 1993, the second post-reform report was issued. This report covered the personal income tax system for the years 1989, 1990 and 1991, and the corporate income tax system for the years 1989 and 1990.

Additional information is now available. Consequently, this document presents estimates for the corporate income tax system for the 1990 and 1991 taxation years using final and preliminary data respectively. For the personal income tax system, estimates are provided for the years 1991 and 1992.

This document also presents tax expenditures for the GST, for the first time. Estimates of the costs of these tax expenditures are provided for 1991 and 1992, the first two years of operation of the GST.

The first part of the report discusses the tax expenditure concept in order to facilitate understanding of the quantitative estimates. It also discusses the calculation and interpretation of the costs of tax expenditures, including key assumptions used in the analysis. The second part of the report presents estimates of the costs of tax expenditures and memorandum items in the personal and corporate income tax systems and the GST.

The report also includes a number of appendices. Descriptions of each tax expenditure as well as information on data sources and methodology used in constructing the estimates are presented in Appendix A (personal), Appendix B (corporate) and Appendix C (GST).

DEFINING TAX EXPENDITURES

There are several ways for the government to achieve its social and economic objectives. The government can regulate private sector activities. It can spend on programs, grants and subsidies. The government may also pursue these policy objectives through measures contained in the tax system. Methods of providing relief from the payment of taxes include tax exemptions, deductions, tax credits and deferrals. Since in many ways these measures represent an alternative form of government assistance with financial implications similar to those of direct expenditures, they are generally referred to as tax expenditures.

Tax expenditures are used to support a variety of goals ranging from promoting savings and investment, to encouraging research and development, to maintaining international competitiveness, to partially defraying the cost of charitable contributions. Many personal income tax measures, such as the age and disability credits, are based on the specific characteristics of taxpayers. Similarly, several corporate tax measures are tied to the characteristics of the business. For example, the small business

deduction is only available to Canadian-controlled private corporations. Other tax expenditures, such as the pension income credit and the manufacturing and processing profits deduction, are linked to the source of income. A third possibility is tax relief linked to the use of funds, such as the Scientific Research and Experimental Development Tax Credit, which is available to businesses making qualified expenditures.

In the case of the GST, a number of measures result in a reduction in tax for particular activities or groups of taxpayers. For example, child care services and municipal transit are exempt from the GST.

What are tax expenditures?

Tax expenditures represent an alternative to direct spending for achieving government policy objectives. They are defined as deviations from a benchmark tax system. Typically, they take the form of exemptions, deductions, credits or deferrals that are available to targeted groups of individuals or businesses.

In order to provide as much information as possible, a broad definition of the benchmark tax system has been adopted.

Given the informational intent of this report, estimates are also provided for some tax measures, such as the dividend tax credit, even though they are usually considered to be part of the benchmark tax system. These tax measures are referred to as memorandum items.

Elements of the Benchmark System

In order to identify tax expenditures, it is necessary to establish a broadly-based benchmark tax structure which does not contain tax preferences. Tax expenditures are then defined as deviations from this benchmark. To ensure that the estimates provide meaningful information on the cost of government operations, the benchmark tax systems used in this document are defined as consisting of the basic structural features of the current federal income tax system and the GST.

Personal and corporate income tax systems

The benchmark for the personal and corporate tax systems includes the existing tax rates and brackets, unit of taxation, time-frame of taxation, treatment of inflation for calculating income and those measures designed to reduce or eliminate double taxation.

The definition of income is crucial in determining what is a tax expenditure. Tax provisions which provide for the deduction of current costs incurred to earn income are considered to be part of the benchmark system and therefore not

tax expenditures. For example, the deductibility of labour costs or economic depreciation of business assets in determining business income would not be considered a tax expenditure.

It is important to emphasize that the definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. Reasonable differences of opinion may exist as to the interpretation and categorization of tax measures. For example, unemployment insurance (UI) premiums paid by an employee could be viewed either as an expense of earning income or as a tax used to finance an income transfer to the unemployed. From the first perspective, the current system of providing employees a tax credit for contributions would not be a tax expenditure. The credit for UI premiums merely recognizes an expense of earning income, and hence, is part of the benchmark tax structure. On the other hand, one could argue that the tax credit for UI contributions represents a tax expenditure because the taxes paid by taxfilers are generally not deductible against personal income taxes. For this reason the tax treatment of UI premiums is reported as a memorandum item. Measures such as these which are subject to debate are discussed on an individual basis in Appendices A and B.

The following provides a more detailed discussion of the features of the benchmark for both the personal and corporate tax systems.

(1) Tax rates and income brackets

For the personal income tax system, the existing rate structure, including surtaxes, is taken to be part of the benchmark system. The basic personal credit is also treated as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax up to an initial level of income. However, the cost of this credit is included as a memorandum item.

With respect to the corporate income tax system, the basic federal corporate tax rate applicable to non-manufacturing corporations is 28.84 per cent including the surtax but after the provincial abatement. Provisions that reduce this tax rate for certain types of activities or corporations are regarded as tax expenditures. These include the lower tax rates for manufacturing and processing profits, and the rate for small business profits, which is available on the first $200,000 of active business income earned by most Canadian-controlled private corporations (CCPCs). The large corporations tax, levied at the existing rate, is also considered to be part of the benchmark tax system because it serves as a corporate minimum tax.

(2) Tax unit

Personal income taxes in Canada are based on individual income. Consequently, the individual is taken as the benchmark tax unit for the purposes of identifying tax expenditures in this report. This choice leads to the classification of the various provisions related to dependants, such as the married credit, as tax expenditures.

The choice of the appropriate unit for the corporate income tax benchmark system raises a number of conceptual issues. There is a wide range of possible tax units, including the establishment or activity unit within a corporation, the single legal corporate entity, and the consolidated group of related corporations. The present income tax system contains elements of all of these approaches. For example, the view that the activity unit is the appropriate unit of taxation is consistent with the "at-risk" rules, which restrict the amount of investment tax credits and business losses that may be flowed out to limited partners. The view that the single legal corporate entity is the relevant tax unit is supported by the fact that income from one part of a business can be offset by other business losses within the same corporation whereas losses by one corporation may not generally be used against the income of another corporation in the group. Other provisions in the current tax system allow corporate groups to reorganize their corporate structures without triggering any capital gains or recaptured depreciation. These rollover provisions lead to a deferral of capital gains and recaptured depreciation, which would be appropriate if the taxation unit is the consolidated group of related corporations. On balance, the view most closely related to the existing system is that of the single legal corporate entity. For this reason, the single corporation is adopted as the benchmark tax unit, together with the availability of various rollover provisions which permit the deferral of capital gains when a corporate structure is changed.

(3) Taxation period

The benchmark taxation period for the personal income tax system in this document is the calendar year. Accordingly, any measures which provide deferrals of taxable income to a subsequent year are considered to be tax expenditures. For example, farmers are permitted to defer the receipt of income from the sale of grain through the use of special cash purchase tickets and this is listed as a tax expenditure.

The benchmark taxation period for the corporate income tax system is the fiscal year. As with the personal tax system, deferrals, such as fast write-offs of Canadian exploration and development expenditures, are considered to be tax expenditures.

A strict application of the annual taxation period would imply that measures which provide for the carry-over of losses to other years would be tax expenditures. However, the relatively cyclical nature of business and investment income suggests that it should be viewed over a number of years. Consequently, carry-overs of business and investment losses are treated as part of the benchmark tax system in this report. Estimates of the cost of these provisions are provided in the memorandum items section.

(4) Treatment of inflation

Both the personal and corporate income tax systems are based on nominal income with a number of provisions that account for the impact of inflation. Nominal income is therefore taken as the appropriate basis for the benchmark tax system. Consequently, special measures, such as the partial exclusion of capital gains from taxable income, which may serve to recognize inflation are identified as tax expenditures.

(5) Avoidance of double taxation

Conceptual difficulties arise in deciding whether certain provisions which reduce or eliminate double taxation should be considered as tax expenditures.

For example, regarding the personal and corporate income tax systems as completely separate would suggest that the dividend tax credit is a tax expenditure. However, the credit is an essential feature of the overall (i.e. both corporate and personal) income tax structure and serves to eliminate or reduce double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation and once at the personal level. For this reason, the dividend tax credit is not considered to be a tax expenditure.

Similarly, the non-taxation of inter-corporate dividends is designed to ensure that income already taxed in one corporation is not taxed again upon receipt of a dividend by another corporation. Without this exemption, double taxation would occur and the corporate income tax system would not be neutral across organizational structures. For example, consider a single corporation that currently operates as a number of divisions. Now suppose it re-organizes into a holding company with wholly-owned subsidiaries instead of divisions. The profits from the subsidiaries flow to the holding company through inter-corporate dividends. If these dividends were subject to taxation at both the subsidiary and the holding company levels, double taxation would occur. Consequently, the exemption of inter-corporate dividends is not considered a tax expenditure.

Similar reasoning applies to the tax exemption on income of foreign affiliates of Canadian corporations. Canada either exempts certain dividend income paid by foreign affiliates from Canadian corporate income tax or it provides a foreign tax credit for income taxes paid in the other country. In either case, the intention is to ensure that income is not subject to double taxation (i.e. once in the country of residence of the foreign affiliate and once again in Canada when the dividends are paid out). A further discussion of this topic and the possible benchmarks that could be considered is contained in Appendix B.

Information on some of these measures that provide relief from "double taxation" is provided in the appropriate memorandum sections of this report.

The benchmark for the income tax system

The definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. A broadly-based system is used as the benchmark for income taxes in this report. The essential features are:

Personal income tax

- *the existing tax rates and income brackets are taken as given;*
- *the tax unit is the individual;*
- *taxation is imposed on a calendar year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the dividend gross-up and credit.*

Corporate income tax

- *the existing general tax rate is taken as given;*
- *the tax unit is the corporation;*
- *taxation is imposed on a fiscal year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the non-taxation of inter-corporate dividends.*

Goods and Services Tax[1]

The benchmark system used to analyze the GST is a broadly-based, multi–stage value-added tax collected according to the destination principle and using a tax credit mechanism to relieve the tax in the case of business inputs. The following provides a more detailed discussion of the features of the GST benchmark.

(1) Multi-stage system

The main structural elements of a multi-stage consumption tax are taken to be part of the benchmark. Under the multi-stage system, tax is applied to the sales of goods and services at all stages of the production and marketing

[1] It should be noted that this analysis deals only with the GST and not with other commodity taxes (e.g., excise taxes).

chain. At each stage, however, businesses are able to claim tax credits to recover the tax they paid on their business inputs. In this way, the tax system has the effect of applying the tax only to the value added by each business. Since the only tax that is not refunded is the tax collected on sales to final consumers, the tax rests ultimately on final consumption.

(2) Destination based

The benchmark system applies tax only to goods and services consumed in Canada. Accordingly, the tax applies to imports as well as domestically produced goods and services. Exports are not subject to the tax.

(3) Single tax rate

The benchmark system has only one tax rate. This rate corresponds to the statutory rate of 7 per cent. As a result, GST provisions that depart from this single rate are considered to be tax expenditures.

(4) Taxation period

The benchmark taxation period is the calendar year.

(5) Constitutional provisions for government sectors

Section 125 of the *Constitution Act, 1867,* provides that "no land or property belonging to Canada or any province shall be liable to taxation". This means that neither the federal nor the provincial governments (or their Crown agents) are liable to taxation by the other. Accordingly, Constitutional immunity from taxation is recognized as part of the benchmark system for the GST.

The benchmark also recognizes that the federal and provincial governments have taken steps to simplify the operation of the tax for transactions involving government sectors.

- The federal government decided to apply the GST to purchases by federal departments and Crown corporations in order to keep the tax as simple as possible for vendors. As a result, the GST and the benchmark system treat federal Crown corporations in the same manner as any other business entity.
- By virtue of Section 125, provincial governments and Crown agents are not liable to pay the GST on their purchases. However, the federal government and most provinces have entered into Reciprocal Tax Agreements (RTAs). These agreements specify situations in which each level of government agrees to pay the sales taxes of the other, and generally this involves applying tax to purchases made by Crown corporations. As a result, provincial Crown corporations are treated like any other business entity in the benchmark system.

Unlike provincial governments, municipalities are liable to pay the GST. Therefore, the benchmark system considers them as paying tax on their purchases. Universities, colleges, schools and hospitals are also considered to pay tax on their purchases. The GST and the benchmark generally treat these sectors as final consumers – that is, they pay GST on their purchases, they do not claim input tax credits and they do not collect GST on their sales.

The only exception to this benchmark treatment arises from the fact that municipalities, universities, colleges, schools and hospitals engage in certain commercial activities analogous to those provided in the private sector. For example, some municipalities operate golf courses. Such commercial activities are taxable under the GST and the GST paid on associated inputs can be claimed as input tax credits.

The benchmark for the Goods and Services Tax

The essential features are:

- *basic structural features of a broadly-based, multi-stage tax system;*
- *destination approach;*
- *7-per-cent rate;*
- *calendar year basis for the taxation period; and*
- *recognition of Constitutional provisions for government sectors.*

Defining GST tax expenditures

Comparing the actual structure of the GST to the benchmark system, it is possible to identify four types of tax expenditure:

- zero-rated goods and services;
- tax-exempt goods and services;
- tax rebates; and
- tax credits.

(1) Zero-rated goods and services

Under the GST, certain categories of goods and services are considered to be taxed at a “zero” rate, rather than at the general tax rate of 7 per cent. Vendors do not charge GST on their sales of zero-rated goods and services (whether these sales are to other businesses or to final consumers). However, vendors are entitled to claim input tax credits to recover the GST they paid on inputs used to produce zero-rated products. As a result, zero-rated goods and services are tax-free.

One category of zero-rated sales is basic groceries, i.e. foods intended to be prepared and consumed at home. Other categories of zero-rated sales include prescription drugs, medical devices and most agricultural and fish products.

(2) Tax-exempt goods and services

Some types of goods and services are exempt under the GST. This means that the GST is not applied to these sales. Unlike zero-rated goods and services, however, vendors of exempt products are not entitled to claim input tax credits to recover the GST they paid on their inputs to these products.

Examples of tax-exempt goods and services include long-term residential rents, most health and dental care services, day care services, most sales by charities, most domestic financial services, municipal transit and legal aid services.

(3) Tax rebates

Certain sectors are eligible for rebates on a portion of the GST paid on inputs. For example, there are rebates for schools, universities, hospitals and municipalities. To the extent that these sectors make taxable sales, they can claim input tax credits to recover the tax they paid on inputs to these sales. Where they provide tax-exempt services, however, they are eligible to receive rebates for only a portion of the GST paid on their inputs to these services. These rebates ensure that these institutions do not bear a greater tax burden on their purchases under the GST than they would have under the manufacturers' sales tax. This treatment constitutes a tax expenditure because, under the benchmark system, these institutions are considered to be final consumers.

Other examples of tax rebates include the rebates for charities, substantially government-funded non-profit organizations and newly built housing. Also, foreign visitors to Canada are able to claim a rebate for the GST they pay on hotel accommodation and on goods they take home. Only the rebate for hotel accommodation is considered to be a tax expenditure, however, because goods taken home by foreign visitors are effectively exports which are not taxable under the benchmark system.

(4) Tax credits

There are two tax credits associated with the GST. These are the GST credit and the transitional credit. The GST credit is provided through the personal income tax system to single individuals and families with low and moderate incomes. In addition, the introduction of the GST was accompanied by the small business transitional credit. This temporary measure provided a one-time credit of up to $1,000 to GST registrants whose taxable sales did not exceed $500,000 in their first full quarter of 1991 or in any three month period beginning in 1990.

GST tax expenditures:

- *zero-rated goods and services;*
- *tax-exempt goods and services;*
- *tax rebates; and*
- *tax credits.*

Memorandum items for the Goods and Services Tax

As indicated earlier, some tax measures are presented as memorandum items even though they are not generally considered to be tax expenditures. For example, the refund of GST for certain employees' expenses is included as a memorandum item.

Many employees, such as commission salespeople, incur significant expenses in the course of carrying out their duties. Examples include restaurant meals and automobile expenses. Often, such expenses are not reimbursed by employers except indirectly through the salaries and commissions paid to employees. Since employees are not considered to be carrying on a commercial activity, they are not able to claim input tax credits for the GST they paid on these expenses. However, employees can receive a refund of the GST paid on those employment expenses that are deductible for income tax purposes. The refund of GST paid on employees' personal consumption expenses would constitute a tax expenditure. However, it is not possible to determine exactly what portion of these expenses should be considered personal consumption. Therefore, the refunds of GST paid on employees' expenses are reported as memorandum items. These items are discussed in more detail in Appendix C.

Calculation and Interpretation of the Estimates

The estimates indicate the cash flow impact to the government of each particular measure. Subject to the limitations described below, the estimates indicate the amount of revenue forgone in each year as a result of the tax expenditure. Accordingly, the estimates covered in this report may not be indicative of the long run or steady state revenue cost associated with each tax expenditure.

The estimates in this document reflect the amount by which federal tax revenues were reduced due to the existence of the various tax measures assuming:

(1) all measures are evaluated independently; and

(2) all other factors remain unchanged.

These methodological distinctions are important and have implications for the interpretation of the estimates. These concepts are discussed in further detail below.

Independent estimates

The estimate of the cost of each tax expenditure is undertaken separately, assuming that all other tax provisions remain unchanged. An important implication of this is that **the estimates cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.**

As explained in more detail in the following paragraphs, this restriction arises from the fact that:

(1) the income tax rate structure is progressive; and

(2) tax measures interact with one another.

(1) Progressive income tax rates

The combined effect of claiming a number of income tax exemptions and deductions may be to move an individual to a lower tax bracket than would have applied had none of the tax measures existed. To the extent that this occurs, aggregation of the individual estimates may underrepresent the "true" cost to the federal government of maintaining all of them. For example, consider a taxpayer whose taxable income was $1,000 below the level at which he or she would move from the 17 into the 26-per-cent tax bracket. Imagine that this taxpayer arrives at this level of taxable income by using two tax deductions of $1,000 each (e.g., home relocation loan and Registered Retirement Savings Plan (RRSP) contribution). Eliminating either deduction by itself would increase taxable income by $1,000 and the taxpayer's federal tax liability by $170. Eliminating both measures simultaneously, however, would not raise the tax liability by $170 + $170, but rather by $170 + $260.

Aggregating the individual estimates for these two items would provide a misleading impression of the revenue impact of eliminating both of them. Therefore, the estimates in this document cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

While there is only one statutory tax rate for corporations, the small business deduction creates a de facto progressive tax rate schedule for some corporations. In this way, the above argument is valid for the corporate income tax system as well, although the effect is not as large as for personal income taxes.

(2) Interaction of tax measures

As noted above, the estimates are computed one at a time, assuming all other provisions remain unchanged. Given that tax provisions sometimes interact, the total cost of a group of tax expenditures calculated individually may differ from the dollar value of calculating the cost of the same group of tax expenditures concurrently. This is because adding the independently estimated costs of the tax provisions would result in double counting and so would not provide an accurate measure of the revenue which would be generated by simultaneously altering a group of measures.

For example, consider the non-taxation of veterans' allowances, which reduces the recipient's net income. Many measures, such as the medical expense credit, are calculated on the basis of net income. Thus, the reported estimate for the non-taxation of veterans' allowances represents not only the direct impact on government receipts of not taxing the allowances, but also the indirect impact of the change on the cost of other tax measures (such as the medical expense credit) which depend on net income.

Since estimates for GST tax expenditures are made using the same methodological approach as for income taxes, they too cannot be aggregated because they may interact. The following discussion of hospital rebates and zero-rating of prescription drugs illustrates the differences between independent and concurrent estimates for these two provisions.

- Eliminating hospital rebates: If hospital rebates were eliminated, hospitals would no longer be able to recover 83 per cent of the GST they pay on their purchases[2]. However, they could continue to purchase prescription drugs on a tax-free basis because these drugs are zero-rated. The estimate for hospital rebates recognizes that the rebate would not have been claimed in respect of zero-rated prescription drugs.
- Eliminating the zero-rating of prescription drugs: If prescription drugs were taxed at the GST rate of 7 per cent, then hospitals would pay the tax on their drug purchases but recover 83 per cent of the tax through the rebate system. Therefore, the estimate for the zero-rating of prescription drugs is calculated as net of the expected increase in the payment of hospital rebates.

[2] Most services provided by hospitals are exempt from the GST. This means that no tax is charged on these services but input tax credits cannot be claimed to recover the tax paid on inputs. However, hospitals are able to claim a rebate of 83 per cent of the GST paid on the inputs they use to provide exempt services.

- Eliminating the two measures concurrently has a revenue impact greater than the sum of the independent estimates because the GST would be payable on prescription drugs and hospitals would be unable to claim a rebate for these purchases.

Aggregation of estimates

The estimates for individual tax expenditures cannot be added together to determine the total cost of tax expenditures. There are two reasons for this:

- *The simultaneous elimination of more than one income tax expenditure would generate different estimates because of progressive income tax rates.*
- *Given the interaction of certain tax measures, the revenue impact of eliminating two or more measures simultaneously would differ from taking the independently estimated numbers published in this document and simply aggregating them.*

All other factors remain unchanged

The estimates in this report represent the amount by which federal tax revenues were reduced due to the existence of each preference assuming that all other factors remain unchanged.

In order to evaluate the extent of the revenue reduction, the approach taken here is to recalculate federal revenues assuming the measure in question has been eliminated. The difference between this recalculated figure and actual revenues provides the quantitative estimate of the cost of the tax expenditure.

The assumption that all other things remain the same means that no allowance is made for (1) behavioural responses by taxpayers, (2) consequential government policy changes, or (3) changes in tax collections due to altered levels of aggregate economic activity which might result from the elimination of a particular tax measure (further detail is provided below). Incorporating these factors would add a large subjective element to the calculations.

(1) Absence of behavioural responses

In many instances, the removal of a tax expenditure would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay, perhaps by making greater use of other tax measures. Therefore, the omission of behavioural responses in the estimating methodology generates cost estimates which may exceed the revenue increases that would have resulted if a particular provision had been eliminated.

As one example, consider the case of the deduction for RRSP contributions. Eliminating this provision would result in the amount of additional federal revenue indicated in the report only if the contributions were not directed to an alternative tax-preferred form of saving. However, the absence of the RRSP deduction might encourage individuals to place their funds instead in some other tax-favoured instrument, such as a Labour Sponsored Venture Capital Corporation. If such a response did occur, eliminating the RRSP deduction would result in a smaller increase in revenues than that indicated.

The effects of this assumption can also be illustrated for the GST by considering the housing rebate. Home owners are eligible for a rebate of the GST they pay on the purchase of new houses. If this rebate were eliminated, the price of new houses would increase relative to the price of used houses. This, in turn, might reduce the demand for new houses while increasing the demand for used houses (which are tax exempt). Since the dynamics of the housing market are not taken into account, the revenues obtained by eliminating the housing rebate could actually be lower than the indicated estimate.

(2) Consequential government policy changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and take no account of other consequential changes in government policy. For example, if the government were to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates in this report do not provide for any such transitional relief.

Similarly, the estimates make no allowance for consequential government policy changes. For example, if lottery winnings were made taxable under the personal income tax system, an argument could be made that the cost of tickets should be deductible in the same way as other investment expenses. Furthermore, it may not be possible to track and assess small gambling winnings. This may mean that a threshold under which winnings would be non-taxable would be required. However, in calculating the cost of providing the exemption for lottery winnings, no allowance is made for such hypothetical consequential government policy changes.

(3) Impact on economic activity

The estimates do not take into account the potential impact of a particular tax provision on the overall level of economic activity and thus aggregate tax revenues. For example, although eliminating the low corporate tax rate for manufacturing and processing could generate a significant amount of revenue for the government, the amount of manufacturing activity could decline, resulting in possible job losses, a reduction in taxable income and hence a reduction in the aggregate amount of tax revenue collected. Furthermore, the derivation of the estimates does not include speculation on how the government might use the additional funds available to it and the possible impacts this could have on other tax revenues.

How to interpret the estimates

Each estimate in this report represents the amount by which federal tax revenues were reduced due to the tax expenditure assuming that all other factors remain unchanged. ***The estimates do not take into account changes in taxpayer behaviour, consequential government actions or feedbacks on aggregate tax collections through induced changes in economic activity. Accordingly, the elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the following tables.***

ESTIMATES

The majority of the personal income tax estimates in this report were computed with a personal income tax model. This model simulates changes to the personal income tax system using the statistical sample of tax returns collected by Revenue Canada for its annual publication *Taxation Statistics*. The model estimates the revenue impact of possible tax changes by re-computing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the moving expense deduction would result not only in a change in net income but also in all of the credits, such as the medical expense tax credit, whose values depend on net income. For those tax expenditures whose costs could not be estimated using this model alone, supplementary data were acquired from a variety of sources. Details on data sources and the methodologies used for estimating the cost of specific personal income tax measures are provided in Appendix A.

A corporate income tax model was used to measure most of the corporate tax expenditures. As with the personal income tax model, it is based on a statistical sample of tax returns collected by Revenue Canada, and is able to re-compute taxes payable on the basis of adjusted tax provisions. This re-computation of taxes takes into account the availability of unused tax credits, deductions, and losses that would be used by the corporation to minimize its tax liability. Where costs could not be estimated using this model alone, supplementary data acquired from a variety of sources were used. Details on these sources are provided in Appendix B.

The costs of the majority of the GST tax expenditures presented in this report were estimated using the Input-Output tables and National Accounts data prepared by Statistics Canada. In cases where estimates were not possible using these statistics alone, supplementary data from a variety of sources were used. Details on both the data sources and methodologies are provided in Appendix C.

Calculation of tax deferrals

Estimating the cost of tax deferrals presents a number of methodological difficulties since, even though the tax is not currently received, it may be collected at some point in the future. It is therefore necessary to derive estimates of the cost to the government of providing such a tax deferral while at the same time ensuring comparability with the other estimates presented here.

In this report, income tax deferrals are estimated on a "current cash-flow" basis. That is, the cost is computed as the forgone tax revenue associated with the additional net deferral in the year (deductions for the current year less the income inclusion from previous deferrals). The estimates thus computed provide a reasonably accurate picture of the ongoing costs of maintaining a particular tax provision in a mature tax system. They can be aggregated over time without double counting and are comparable to estimates of the costs associated with tax credits and deductions.

Comparison with direct expenditures

In comparing the cost of the tax expenditures in this report to direct spending estimates, it should be noted that a dollar of tax preference is often worth substantially more to the taxpayer than a dollar of direct spending. This results from the fact that, in most cases, government grants (i.e. direct spending) are taxable to the recipients. For example, consider an individual facing a marginal tax rate of 29 per cent. A deduction of $100 would be worth $29. If, instead, the government were to provide the individual with a taxable grant of $29, after-tax income would increase by only $20.59 since he/she would face an income tax liability of $8.41 ($29 x 29%).

The same conclusions do not always apply to tax expenditures provided to corporate taxpayers. Consider for example an investment tax credit to a corporation with respect to capital equipment acquired to carry out R&D in Canada. The cost to the government of providing a 20-per-cent tax credit would, in most circumstances, be the same as it would be if the government had provided a direct grant of 20 per cent. This is because investment tax credits are considered to be assistance and are therefore treated in the same manner as direct government grants or subsidies. The 20-per-cent tax credit, like a direct grant, is either included in income, and subject to corporate income tax, or it reduces the capital or other costs deductible by the taxpayer.

The estimates

Table 1 provides estimates of the cost to the federal government of personal income tax expenditures for 1991 and 1992 grouped according to functional categories. Table 2 provides estimates of the cost of corporate income tax expenditures for 1990 and 1991 for all corporations and by major industrial sector. The 1990 estimates in Table 2 are based on final data and may differ from the figures in last year's edition of this document, which were based on preliminary data. The grouping into functional categories is not intended as a policy justification for the specific provisions nor is it the case that all tax measures fall neatly into one of the categories. The categories are provided solely for organizational purposes. Table 3 provides the estimates of the revenue forgone for each of the tax expenditures associated with the GST for the years 1991 and 1992. These departures from the benchmark have been grouped according to the type of tax expenditure.

All estimates are reported in millions of dollars. The letter "S" indicates that the cost is less than $2.5 million while "n.a." signifies that data were not available. The inclusion in the report of items for which estimates are not available is warranted given that the report is designed to provide information on the type of assistance delivered through the tax system even if it is not always possible to provide a quantitative estimate. Work is continuing to replace "n.a."s with quantitative estimates where possible. For example, the corporate income tax entry dealing with holdback on progress payments to contractors was an "n.a." in last year's report. In this year's publication a dollar value is reported.

Table 1
*Personal income tax expenditures**

	1991	1992
	(millions of dollars)	
Culture and recreation		
Non-taxation of lottery and gambling winnings	860	900
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S
Deductions for clergy residence	48	50
Flow through of CCA on Canadian films	8	11
Write-off of Canadian art purchased by unincorporated business	n.a.	n.a.
Assistance for artists	n.a.	n.a.
Deduction for artists and musicians	n.a.	n.a.
Non-taxation of capital gains on gifts of cultural property	n.a.	n.a.
Education		
Exemption on first $500 of scholarship, fellowship and bursary income	8	10
Deduction of teachers' exchange fund contributions	S	S
Tuition fee credit	150	155
Education credit[1]	34	44
Education and tuition fee credits transferred[2]	130	165
Registered education savings plans	n.a.	n.a.
Employment		
Deduction of home relocation loans	6	4
Non-taxation of strike pay[3]	12	n.a.
Non-taxation of allowances for volunteer firefighters	4	4
Northern residents deductions	235	235
Overseas employment credit	16	27
Employee stock options	18	25
Deferral of salary through leave of absence/sabbatical plans	n.a.	n.a.
Employee benefit plans	n.a.	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 12 to 17 for a discussion of the reasons for this.

Personal income tax expenditures (cont'd)

	1991	1992
	(millions of dollars)	
Family		
Married credit	1,100	1,140
Equivalent-to-married credit	565	585
Dependant credit	400	435
Refundable child tax credit	2,215	2,360
Deferral of capital gains through transfers to spouse	n.a.	n.a.
Farming and fishing		
$500,000 lifetime capital gains exemption for farm property	235	250
Deferral of income from destruction of livestock	S	S
Deferral of income on grain sold through cash purchase tickets[4]	-18	-12
Deferral through ten-year capital gain reserve	-29	-30
Deferral of capital gain through intergenerational rollovers of family farms	n.a.	n.a.
Exemption from making quarterly tax instalments	n.a.	n.a.
Cash basis accounting	n.a.	n.a.
Flexibility in inventory accounting	n.a.	n.a.
Federal/provincial financing arrangements		
Quebec abatement	2,125	2,095
Transfers of income tax room to provinces	8,815	8,700
General business and investment		
$100,000 lifetime capital gains exemption	665	735
Partial inclusion of capital gains	665	745
Deduction of research and development expenditures[5]	13	7
Deduction of limited partnership losses	230	220
Investment tax credit	49	58
Deferral through five-year reserve[6]	-58	-14
Deferral through capital gains rollovers	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.
$1,000 capital gain on personal-use property	n.a.	n.a.
$200 capital gains exemption on foreign exchange transactions	n.a.	n.a.
Taxation of capital gains upon realization	n.a.	n.a.

Personal income tax expenditures (cont'd)

	1991	1992
	(millions of dollars)	
Health		
Non-taxation of employer-paid insurance benefits for group private health and dental plans[7]	990	1125
Disability credit	255	265
Medical expenses credit	210	225
Income maintenance and retirement		
Non-taxation of guaranteed income supplement and spouse's allowance benefits	235	290
Non-taxation of social assistance benefits[8]	605	680
Non-taxation of workers' compensation benefits[9]	695	610
Non-taxation of certain income from personal injury awards	S	S
Non-taxation of employer-paid premiums for group term life insurance of up to $25,000	155	160
Non-taxation of RCMP pension/compensation for injury, disability or death	8	9
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)	33	24
Non-taxation of veterans' disability pensions and support for dependants	150	170
Treatment of alimony and maintenance payments	205	200
Age credit	1,315	1,355
Pension income credit	285	295
Saskatchewan pension credit	S	S
Registered retirement savings plans[10]		
Deduction for contributions	3,310	3,685
Non-taxation of investment income[11]	2,980	2,755
Taxation of withdrawals	-925	-940
Registered pension plans		
Deduction for contributions	4,460	4,990
Non-taxation of investment income[11]	8,950	7,690
Taxation of withdrawals	-4,030	-4,580
Deferred profit sharing plans	n.a.	n.a.
Non-taxation of up to $10,000 of death benefit	n.a.	n.a.
Non-taxation of investment income on life insurance policies[12]	–	–

Personal income tax expenditures (cont'd)

	1991	1992
	(millions of dollars)	
Resource sector		
Deduction of resource-related expenditures	37	51
Assistance for prospectors and grubstakers	S	S
Small business		
$500,000 lifetime capital gains exemption for small business shares	585	785
Deduction of allowable business investment losses	130	89
Labour-sponsored venture capital corporations credit	29	62
Deferral through ten-year capital gain reserve	-13	-7
Stock options for CCPC employees	n.a.	n.a.
Other Items		
Non-taxation of income from War Savings Certificates/Victory Bonds	S	S
Non-taxation of capital gains on principal residences		
Partial inclusion rate	3,190	3,755
Full inclusion rate	4,425	5,200
Non-taxation of income from the Office of the Governor General	S	S
Charitable donations credit	845	865
Gifts to the Crown credit	22	17
Political contributions credit	11	10
Non-taxation of income of Indians on reserves	n.a.	n.a.
Non-taxation of gifts and bequests	n.a.	n.a.
Memorandum items		
Non-taxation of allowances for certain public officials	5	5
Non-taxation of allowances for diplomats and other government employees posted abroad	9	10
Child care expense deduction[13]	295	315
Attendant care expense deduction	S	S
Moving expense deduction	65	59
Deduction of carrying charges incurred to earn income	655	585
Deduction of meals and entertainment expenses	100	80
Deduction of farm losses for part-time farmers	51	52
Farm and fishing loss carry-overs[14]	12	11
Capital loss carry-overs	42	50
Non-capital loss carry-overs	44	53

Personal income tax expenditures (cont'd)

	1991	1992
	(millions of dollars)	
Logging tax credit	S	S
Deduction of accelerated tax depreciation not reported elsewhere	98	100
Deduction of other employment expenses	485	455
Deduction of union and professional dues	410	440
Unemployment insurance[15]		
Unemployment insurance contribution credit	995	1,220
Non-taxation of employer-paid premiums	2,010	2,485
Canada and Quebec pension plan credit[16]		
Canada and Quebec pension plan contribution credit	865	930
Non-taxation of employer-paid premiums	1,120	1,210
Foreign tax credit	130	150
Dividend gross-up and credit	700	640
Basic personal credit	16,960	17,265
Non-taxation of capital dividends	n.a.	n.a.

Footnotes

1 Starting taxation year 1992, the education amount was increased from $60 to $80 per month of full-time study.

2 Effective taxation year 1992, the limit on the total amount of tuition fee and education credits that may be claimed by a supporting person was increased from $600 to $680.

3 The 1992 data were not available as of the date of publication.

4 The estimate is computed on a cash-flow basis. In 1991 and 1992, the amounts of outstanding cash tickets declined, and consequently gave rise to negative estimates.

5 The 1991 estimate published in the previous edition of this report ($16 million) has been revised to reflect the availability of additional sources of information provided by Revenue Canada regarding the proportion of R&D expenditures that are of a capital nature.

6 Amounts brought back into income from previously created capital gains reserves exceeded amounts set aside in newly-established reserves, giving rise to negative estimates for both years.

7 The 1991 estimate published in the previous edition of this report ($830 million) has been revised to reflect the availability of additional sources of information provided by the Canadian Life and Health Insurance Association in their survey "Health Insurance Benefits in Canada."

8 The estimates published in previous editions of this report reflected only federal transfers under the Canada Assistance Plan. Revised estimates, reflecting full payments to recipients are as follows: $395 million for 1988, $415 million for 1989, $515 million for 1990.

9 Prior to taxation year 1992, taxpayers were not required to itemize workers' compensation benefits on their tax returns. For the first time, the 1992 estimate is based on workers' compensation benefits reported for tax purposes. The 1991 estimate is based on data provided by Human Resources Development Canada.

[10] The methodology for calculating tax revenues from the taxation of withdrawals has been modified to reflect an estimate of the value of annuity income derived from RRSPs. This affects not only the value of withdrawals but also the value of assets held in RRSPs throughout the year, and in turn the estimated value of investment income. As a result, the 1991 estimates differ from those of the previous publication ($2,960 million for the non-taxation of investment income and $735 million for the taxation of withdrawals).

[11] The decline in 1992 for this tax expenditure reflects the generally lower interest rate earned in registered plans in that year.

[12] Although this measure does provide tax relief to individuals, it is implemented through the corporate income tax system. See the corporate income tax expenditure section of this report for an estimate of the value of this tax expenditure.

[13] The methodology for calculating the value of this estimate has been modified to reflect the estimated impact of eliminating the child care expense deduction on the amount of refundable child tax credit. As a result, the 1991 estimate differs from that in the previous publication ($330 million).

[14] The 1991 estimate differs from that in the previous publication ($6 million) because the estimates are now obtained from the personal income tax simulation model.

[15] Unemployment insurance premium rates increased from $2.53 per $100 of earnings in 1991 to $3.00 in 1992.

[16] Canada and Quebec Pension Plan premium rates increased between 1991 and 1992, from $2.3 to $2.4 per $100 of earnings.

Table 2
*Corporate income tax expenditures**
All corporations

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses[1]	2,356	2,037
Low tax rate for manufacturing and processing	324	353
Low tax rate for credit unions	50	50
Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations	n.a.	n.a.
Exemption from tax for international banking centres	n.a.	n.a.
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit[2]	437	543
Atlantic Canada Investment Tax Credit	55	46
Special Investment Tax Credit	20	39
Cape Breton Investment Tax Credit	3	3
Exploration Tax Credit	19	5
ITCs claimed in current year but earned in prior years[3]	230	150
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	396	415
Resource allowance		
Resource allowance in lieu of deductibility of provincial royalties[4]	59	-131
Deductibility of provincial royalties for the Syncrude project	41	24
Deductibility of royalties paid to Indian bands	n.a.	n.a.
Earned depletion[5]	97	46
Deductibility of itemized charitable donations	88	75
Gifts to the Crown	S	S
Non-deductibility of advertising expenses in foreign media	n.a.	n.a.
Non-taxation of provincial assistance for venture investments in small business	n.a.	n.a.

* The elimination of a tax expenditures would not necessarily yield the full tax revenues shown in the table. See pages 12 to 17 for a discussion of the reasons for this.

All corporations (cont'd)

	1990	1991
	(millions of dollars)	
Deferrals		
Fast write-off for Canadian development expenses[6]	147	107
Fast write-off for Canadian exploration expenses[6]	444	359
Fast write-off for capital equipment used for scientific research and experimental development	43	45
Allowable business investment loss	36	70
Holdback on progress payments to contractors	26	-12
Deductibility of carrying charges on land	18	5
Available for use[7]	–	–
Capital gains taxation on realization basis	n.a.	n.a.
Expensing of advertising costs	n.a.	n.a.
Cash basis accounting	n.a.	n.a.
Flexibility in inventory accounting	n.a.	n.a.
Deferral of income		
On grain sales	n.a.	n.a.
On destruction of livestock	n.a.	n.a.
Deferral of tax from use of billed-basis accounting by professionals	n.a.	n.a.
International		
Non-taxation of life insurance companies' world income	65	85
Exemption from non-resident withholding tax	n.a.	n.a.
Exemption of foreign shipping and aircraft companies from Canadian income tax	n.a.	n.a.
Other tax expenditures		
Transfer of income tax room to provinces in respect of shared programs	493	420
Interest credited to life insurance policies	55	55
Non-taxation of registered charities and other non-profit organizations	n.a.	n.a.
Income tax exemption for provincial and municipal corporations	n.a.	n.a.
Non-taxation of certain federal Crown corporations	n.a.	n.a.
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	874	886

All corporations (cont'd)

	1990	1991
	(millions of dollars)	
Refundable Part I tax on investment income of private corporations	889	876
Refundable capital gains for special investment corporations[8]	81	131
Loss carry-overs		
Non-capital loss	1,376	1,280
Net capital loss	n.a.	n.a.
Farm losses and restricted farm losses	n.a.	n.a.
Meals and entertainment expenses	410	392
Large corporations tax		
Threshold	420	500
Exempt corporations	n.a.	n.a.
Patronage dividend deduction by credit unions and co-operatives	189	130
Logging tax credit	10	3
Non-resident-owned investment corporation refund[8]	7	49
Investment corporation deduction	S	S
Deferral of capital gains income through various rollover provisions	n.a.	n.a.
Excess deduction for intangible assets	n.a.	n.a.
Tax exemption on income of foreign affiliates of Canadian corporations	n.a.	n.a.

Agriculture, Forestry, Fishing

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	90	85
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	8	3
Deductibility of itemized charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	7	6
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-6	-9
Refundable Part I tax on investment income of private corporations	12	12
Loss carry-overs		
Non-capital losses	21	8
Meals and entertainment expenses	S	S
Patronage dividend deduction by credit unions and co-operatives	S	S
Logging tax credit	S	S

Manufacturing

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	219	199
Low tax rate for manufacturing and processing	260	295
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	182	218
Atlantic Canada Investment Tax Credit	25	15
Special Investment Tax Credit	16	39
Cape Breton Investment Tax Credit	S	3
ITCs claimed in current year but earned in prior years	123	80
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	27	35
Deductibility of itemized charitable donations	15	16
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	20	20
Allowable business investment loss	5	5
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	118	96
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	175	4
Refundable Part I tax on investment income of private corporations	23	19
Loss carry-overs		
Non-capital losses	367	415
Meals and entertainment expenses	91	92
Patronage dividend deduction by credit unions and co-operatives	73	28
Logging tax credit	9	S

Construction

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	380	289
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	17	11
Deductibility of itemized charitable donations	4	4
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	S	6
Holdback on progress payments to contractors	26	-12
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	39	26
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	14	21
Refundable Part I tax on investment income of private corporations	42	34
Loss carry-overs		
Non-capital losses	96	86
Meals and entertainment expenses	29	26

Transportation and storage

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	75	81
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	6	S
Atlantic Canada Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	9	7
Deductibility of itemized charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	10	12
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	10	31
Refundable Part I tax on investment income of private corporations	9	8
Loss carry-overs		
Non-capital losses	69	28
Meals and entertainment expenses	15	17
Patronage dividend deduction by credit unions and co-operatives	S	7
Logging tax credit	S	S

Communications

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	6	5
Low tax rate for manufacturing and processing	8	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	58	84
Atlantic Canada Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	21	14
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	S
Deductibility of itemized charitable donations	16	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	7	10
Allowable business investment loss	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	21	21
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	8	54
Refundable Part I tax on investment income of private corporations	S	S
Loss carry-overs		
Non-capital losses	8	4
Meals and entertainment expenses	13	12

Public utilities

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	7	4
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	S
Deductibility of itemized charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	6	6
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	56	63
Refundable Part I tax on investment income of private corporations	S	S
Loss carry-overs		
Non-capital losses	7	7
Meals and entertainment expenses	3	S
Patronage dividend deduction by credit unions and co-operatives	S	S

Wholesale trade

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	283	226
Low tax rate for manufacturing and processing	18	25
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	63	92
Atlantic Canada Investment Tax Credit	S	4
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	20	13
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	33	12
Deductibility of itemized charitable donations	7	7
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	5	6
Allowable business investment loss	3	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	54	42
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	22	71
Refundable Part I tax on investment income of private corporations	37	17
Loss carry-overs		
Non-capital losses	119	133
Meals and entertainment expenses	77	58
Patronage dividend deduction by credit unions and co-operatives	32	32
Logging tax credit	S	S

Retail trade

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	358	347
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	31
Atlantic Canada Investment Tax Credit	S	9
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	11	3
Deductibility of itemized charitable donations	4	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	34	26
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	6	23
Refundable Part I tax on investment income of private corporations	43	33
Loss carry-overs		
Non-capital losses	198	58
Meals and entertainment expenses	24	27
Patronage dividend deduction by credit unions and co-operatives	11	10

Finance

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	252	272
Low tax rate for manufacturing and processing	S	6
Low tax rate for credit unions	50	50
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	29	47
Atlantic Canada Investment Tax Credit	S	5
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	14	9
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	210	323
Deductibility of itemized charitable donations	25	29
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	3	4
Allowable business investment loss	21	44
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	106	124
Interest credited to life insurance policies	55	55
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	420	561
Refundable Part I tax on investment income of private corporations	625	687
Refundable capital gains for special investment corporations	81	131
Loss carry-overs		
Non-capital losses	240	260
Meals and entertainment expenses	56	65
Patronage dividend deduction by credit unions and co-operatives	65	53
Non-resident-owned investment corporation refund	6	49
Investment corporation deduction	S	S

Services

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	617	484
Low tax rate for manufacturing and processing	5	6
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	51	48
Atlantic Canada Investment Tax Credit	3	3
Special Investment Tax Credit	3	S
Cape Breton Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	7	4
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	42	11
Deductibility of itemized charitable donations	5	5
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	5	14
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	59	41
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	208	234
Refundable Part I tax on investment income of private corporations	85	51
Loss carry-overs		
Non-capital losses	88	100
Meals and entertainment expenses	62	57
Patronage dividend deduction by credit unions and co-operatives	S	S
Non-resident-owned investment corporation refund	S	S
Investment corporation deduction	S	S

Oil and gas

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	10	8
Low tax rate for manufacturing and processing	25	15
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	28	12
Atlantic Canada Investment Tax Credit	15	8
Exploration Tax Credit	19	5
ITCs claimed in current year but earned in prior years	26	17
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	3	7
Resource allowance		
Resource allowance in lieu of deductibility of provincial royalties	-55	-161
Deductibility of provincial royalties for the Syncrude project	41	24
Earned depletion	87	40
Deductibility of itemized charitable donations	7	6
Gifts to the Crown	S	S
Deferrals		
Fast write-off for Canadian development expenses	90	82
Fast write-off for Canadian exploration expenses	341	283
Fast write-off for capital equipment used for scientific research and experimental development	4	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	27	16
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-55	-129
Refundable Part I tax on investment income of private corporations	S	4
Loss carry-overs		
Non-capital losses	126	102
Meals and entertainment expenses	15	5
Patronage dividend deduction by credit unions and co-operatives	5	S

Mining

	1990	1991
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	21	22
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	11	3
Atlantic Canada Investment Tax Credit	8	2
Cape Breton Investment Tax Credit	3	S
ITCs claimed in current year but earned in prior years	10	7
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	31	3
Resource allowance		
Resource allowance in lieu of deductibility of provincial royalties	114	30
Earned depletion	10	6
Deductibility of itemized charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for Canadian development expenses	57	25
Fast write-off for Canadian exploration expenses	103	76
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment loss	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	9	4
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	17	-36
Refundable Part I tax on investment income of private corporations	8	7
Loss carry-overs		
Non-capital losses	36	77
Meals and entertainment expenses	6	9

Footnotes

1 The decrease in revenue cost for the low tax rate on small businesses was due to the decline in taxable income between 1990 and 1991.

2 The number of claimants increased by about 1,100 in 1991 compared to 1990.

3 The reduction in the carry forward of ITCs from previous years reflects a reduction in corporate profits.

4 The decrease between 1990 and 1991 in the cost of the resource allowance was primarily due to reduced profits in both the mining and oil and gas sectors. The overall result was a negative estimate (i.e. the resource allowance was less than the disallowed deductions for Crown charges).

5 The lower value for 1991 is due to the elimination of the earned depletion allowance. There have been no new additions to this expenditure pool since 1989.

6 Tax expenditure costs for CDE and CEE declined between 1990 and 1991 primarily due to lower levels of spending on exploration and development by resource companies.

7 Although this measure existed in 1990 and 1991, the tax expenditure associated with it could occur only in 1992 and subsequent years. A more detailed explanation is provided in Appendix B.

8 The increase between 1990 and 1991 is mainly due to an increase in dividend distributions to shareholders.

Table 3
*GST tax expenditures**

	1991	1992
	(millions of dollars)	
Zero-rated goods and services		
Basic groceries	2,410	2,455
Prescription drugs	155	170
Medical devices	135	145
Agricultural and fish products and purchases	S	S
Certain zero-rated purchases made by exporters	S	S
Non-taxable importations	n.a.	n.a.
Tax exempt goods and services		
Long-term residential rent	965	1,015
Health care services	305	325
Education services (tuition)	280	305
Child care and personal services	85	100
Legal aid services	15	25
Ferry, road and bridge tolls	5	5
Municipal transit	55	60
Exemption for small businesses	100	105
Quick method accounting	50	50
Water and basic garbage collection services	85	100
Domestic financial services	n.a.	n.a.
Exempt supplies made by non-profit organizations	n.a.	n.a.
Tax rebates		
Rebates for municipalities	485	500
Rebates for hospitals	280	280
Rebates for schools	270	290
Rebates for universities	115	115
Rebates for colleges	45	50
Rebates for charities	105	110
Rebates for non-profit organizations	65	70
Housing rebate	395	440
Rebate for foreign visitors on accommodation	15	15
Special credit for certified institutions	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 12 to 17 for a discussion of the reasons for this.

GST tax expenditures (cont'd)

	1991	1992
	(millions of dollars)	
Tax credits		
Small business transitional credit	900	0
The GST credit	2,245	2,490
Memorandum items		
Meals and entertainment expenses	180	185
Rebate to employees and partners	50	55
Sales of personal-use real property	n.a.	n.a.

APPENDIX A
DESCRIPTION OF PERSONAL TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a simplified reference. It should be noted that the explanations refer to the 1991 and 1992 taxation years. Since that time, some provisions have been altered.

A number of measures which primarily affect corporations, but also have an impact on non-incorporated businesses, are treated under the corporate income tax measures section.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the personal income tax simulation model described in the main text.

Culture and Recreation

Non-taxation of lottery and gambling winnings

Lottery and gambling winnings are excluded from income for tax purposes.

The estimate for the non-taxation of winnings in government lotteries is based on information provided by Statistics Canada. Values for the non-taxation of winnings from horse racing are estimated using data provided by Agriculture Canada.

The values do not include amounts from other types of gambling, such as bingo, where no accurate data are available. As a result, the cost of the tax expenditure may be underestimated. On the other hand, no adjustments are made for the possible deductibility of lottery ticket purchases which might accompany the taxation of lottery winnings.

Deduction for certain contributions by individuals who have taken vows of perpetual poverty

Where a person has taken a vow of perpetual poverty as a member of a religious order, that person may deduct donations to the religious order up to his/her total employment and pension income (but not investment or other income) in lieu of the charitable donations credit.

Deduction for clergy residence

A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct housing costs from income for tax purposes. Where a member of the clergy is supplied living accommodation by his/her employer or receives housing allowances, an offsetting deduction may be claimed to the extent that this benefit is included in income. The estimate for this item is based on the number of clergy in Canada and Statistics Canada expenditure data on rent.

Flow through of CCA on Canadian films

The capital cost allowance (CCA) rate generally available on films is 30 per cent subject to the half-year rule. On "certified Canadian films", the half-year rule does not apply. The CCA may be flowed through to investors and deducted against their other sources of income. An additional allowance of up to the remaining undepreciated capital cost of the film is deductible against an investor's income from certified Canadian films. Investments in television commercials may be depreciated at a rate of 100 per cent.

Losses arising from CCA claimed at the partnership level and flowed through as limited partnership losses are included in the "Deduction of limited partnership losses" tax expenditure. It is estimated that 15 per cent of limited partnership losses relate to CCA on Canadian films.

Write-off of Canadian art purchased by unincorporated businesses

Canadian art acquired by businesses for display in an office may be depreciated on a 20-per-cent declining balance basis even though Canadian art may depreciate at a much slower rate, and may even appreciate.

No data are available.

Assistance for artists

Artists may deduct the costs of creating a work of art in the year the costs are incurred rather than in the year the work of art is sold.

Artists may also elect to value a charitable gift from their inventories at any amount up to its fair market value. This value is then used to determine the artist's income and the amount that qualifies for the charitable donations credit. The restriction that donations eligible for the charitable donations tax credit cannot exceed 20 per cent of income does not apply.

No data are available.

Deduction for artists and musicians

Employed musicians are able to claim the cost of maintenance, rental, insurance and capital cost allowance on musical instruments against employment income earned as a musician.

Since 1991, employed artists have also been entitled to deduct expenses related to their artistic endeavours up to the lesser of $1,000 or 20 per cent of their income derived from employment in the arts.

No data are available.

Non-taxation of capital gains on gifts of cultural property

Certain objects certified as being of cultural importance to Canada are exempt from capital gains tax if donated to a designated museum or art gallery.

Such donations amounted to $58 million in 1991, and $51 million in 1992. However, there is no information on the portion of the value which is attributable to capital gains.

Education

Exemption on first $500 of scholarship, fellowship and bursary income

The first $500 of scholarship, fellowship and bursary income is exempt from income tax.

The values reported in the table are understated since no data are available on individuals receiving scholarship, fellowship or bursary income of less than $500.

Deduction of teachers' exchange fund contributions

Teachers may deduct up to $250 per year in contributions to a fund established by the Canadian Education Association for the benefit of teachers from Commonwealth countries visiting Canada under a teachers' exchange agreement.

Tuition fee credit

A 17-per-cent tax credit is available for tuition fees paid by students to a prescribed educational institution. The credit is not available if the total tuition fees paid to institutions are $100 or less.

Education credit

Students who are enrolled at prescribed educational institutions on a full-time basis are entitled to claim a tax credit of 17 per cent of $60 in 1991, and of $80 in 1992, for every month of full-time attendance.

Education and tuition credits transferred

The unused portion of the education and the tuition fee amounts may be transferred to a supporting spouse, parent or grandparent . The maximum transfer for the two credits combined is 17 per cent of $4,000.

Registered education savings plans

A taxpayer may contribute to a registered education savings plan on behalf of a designated beneficiary (usually the taxpayer's child). The investment return on these funds is not taxable until it is withdrawn by the beneficiary for educational purposes and is generally taxable in the hands of the beneficiary rather than the contributor.

No data are available.

Employment

Deduction of home relocation loans

An offsetting deduction for up to five years is provided from taxable income for the benefit received by an employee in respect of a home relocation loan. The amount of the deduction is the lesser of the amount included in income as a taxable benefit and the amount of the benefit that would arise in respect of an interest-free loan of $25,000.

Non-taxation of strike pay

Strike pay is non-taxable.

The estimates are based on data provided by Statistics Canada's annual report on Corporations and Labour Unions Return Act Part II (CALURA, Catalogue 71-202).

Non-taxation of allowances for volunteer firefighters

Volunteer firefighters may receive up to $500 per year of allowances which are not taxable.

The estimates are based on census data.

Northern residents deduction

Individuals living in prescribed areas in Canada for a specified period may claim the northern residents deductions, made up of a residency deduction and a deduction for employer-provided travel benefits. The benefits are a residency deduction of up to $15 a day, a deduction for two employer provided vacation trips per year, and unlimited employer-provided medical travel. Residents of the Northern Zone are eligible for full benefits, while residents of the Intermediate Zone are eligible for 50 per cent of the full deductions.

The new definition of prescribed areas came into force in 1991. Certain communities which had qualified under the pre-1991 regime but which are no longer eligible under the current system will continue to receive gradually diminishing deductions until the end of 1994. Other communities which had qualified under the pre-1991 regime but are eligible for 50 per cent of the full deductions under the current system will receive gradually diminishing deductions until 1994 when they reach 50 per cent of full benefits.

Overseas employment credit

A tax credit is available to Canadian employees working abroad for more than six months in connection with certain resource, construction, installation, agricultural or engineering projects. The credit is equal to the tax otherwise payable on 80 per cent of the employee's net overseas employment income taxable in Canada, to a maximum credit of $80,000.

Employee stock options

Employees are not generally required to report any employment benefit on employer-provided stock options until the option is exercised. At that time, a deduction of one-quarter of the difference between the option price and the fair market value is provided. This provides both a deferral of tax and a preferential rate.

The estimates are computed by assuming the elimination of the deduction, and therefore do not capture the deferral benefit.

Deferral of salary through leave of absence/sabbatical plans

Employees may be entitled to defer salaries through a leave of absence/sabbatical plan. These amounts are not subject to tax until received.

No data are available.

Employee benefit plans

In certain circumstances, employers may make contributions to an "employee benefit plan" on behalf of their employees. The employee is not required to include in income the contributions to the plan or the investment income earned within the plan until amounts are received. Employers may not deduct these contributions to the plan until these contributions are actually distributed to the employees.

No data are available.

Non-taxation of certain non-monetary employment benefits

Certain fringe benefits provided to employees by their employers are not taxable. Examples include subsidized meals in staff cafeterias, subsidized recreational facilities and special clothing.

No data are available.

Family

Married credit

A married taxpayer supporting a spouse was entitled to a tax credit of 17 per cent of $5,233 in 1991 and of $5,380 in 1992. This credit was reduced by 17 per cent of the amount by which the dependent spouse's income exceeded $524 in 1991 and $538 in 1992.

Equivalent-to-married credit

An "equivalent-to-married" tax credit may be claimed in respect of a dependent child under 18 or a parent or grandparent by taxpayers without a spouse. The amount of the credit and the limitation on the dependant's income are the same as for the married credit.

Dependant credit

Taxpayers could claim a credit in respect of children and other qualified dependent relatives who were either under the age of 19 or mentally or physically infirm. In 1991, the tax credit was $406 for each of the first two dependants under the age of 19, $812 for each additional dependant under the age of 18 and $1,540 for each infirm dependant. These amounts were reduced by 17 per cent of the amount of the dependant's income in excess of $2,617. The amounts for 1992 were $417, $834, $1,583 and $2,690 respectively. The credit for dependants under the age of 18 was replaced by the child tax benefit for 1993 and subsequent years.

Refundable child tax credit

Individuals receiving family allowances were entitled to an income-tested refundable child tax credit. The basic amount was $585 in 1991 and $601 in 1992. A supplement of $207 in 1991 and $213 in 1992 was available for each child under the age of seven. This supplement was reduced by 25 per cent of all child care expenses claimed as a deduction. The combined credit was reduced by 5 per cent of the amount of the parents' net income in excess of $25,215 for 1991 and $25,921 in 1992. The credit was replaced by the child tax benefit for 1993 and subsequent years.

Deferral of capital gains through transfer to spouse

Individuals may transfer capital property to their spouses or spousal trusts at the adjusted cost base of the property rather than the fair market value. This provides a deferral of the capital gain until the subsequent disposition of the property or until the transferee spouse dies.

Property transferred to other family members or to unrelated individuals (or to trusts of which they are beneficiaries) is treated differently. The transferor is generally deemed to have disposed of the property at the time of transfer and must include any resulting capital gain in income at that time.

In the case of property transferred to a trust, the tax treatment again differs depending on whether or not the beneficiary of the trust is a spouse. The treatment of spousal trusts is described above. For non-spousal trusts, capital gains are subject to tax not only when property is transferred to the beneficiary, but also periodically while it remains in the trust. These periodic deemed dispositions generally occur every 21 years. However, the period can be extended until the rights of beneficiaries expire, provided those beneficiaries are the children or other qualifying beneficiaries of the individual who created the trust.

No data are available.

Farming and Fishing

$500,000 lifetime capital gains exemption for farm property

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified farm property. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption and the $500,000 lifetime capital gain exemption on small business shares have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Deferral of income from destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

The estimates are based on data provided by Agriculture Canada.

Deferral of income on grain sold through cash purchase tickets

Under the cash purchase ticket program of the Canadian Wheat Board, farmers may make deliveries of grain before the year-end and receive payment in the form of a ticket that may be cashed in subsequent years. The payment is included in income only when the ticket is cashed.

The estimates are based on data provided by the Canadian Wheat Board. In 1991 and 1992, the amount of cash tickets outstanding declined and so gave rise to negative estimates.

Deferral through ten-year capital gain reserve

If proceeds from a sale of a farm property to a child, grandchild or great-grandchild are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year, creating a maximum ten-year reserve period. For most other assets the maximum reserve period is five years. Amounts brought back into income from reserves exceeded amounts set aside in newly-established reserves in 1991 and 1992, giving rise to negative estimates.

Deferral of capital gain through intergenerational rollovers of family farms

Sales or gifts of assets to children, grandchildren or great-grandchildren typically give rise to taxable capital gains to the extent that the fair market value exceeds the cost base of the property. However, capital gains on intergenerational transfers of farm property are deferred until the property is disposed of outside the immediate family.

No data are available.

Exemption from making quarterly tax instalments

Taxpayers earning business income must normally pay quarterly income tax instalments. However, individuals engaged in farming and fishing pay two-thirds of their estimated tax payable at the end of the taxation year and the remainder on or before April 30 of the following year.

No data are available.

Cash basis accounting

Individuals engaged in farming and fishing may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues, and expenses are deductible for the period to which they relate.

No data are available.

Flexibility in inventory accounting

Farmers using the cash basis method of accounting are allowed to depart from it with regard to their inventory. Under cash accounting, net additions to inventory are treated as a cost which is deducted in computing income. When inventory is increasing from year to year, such costs could create a loss for tax purposes. However, a discretionary amount, not exceeding the fair market value of farm inventory on hand at year-end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farmers to avoid creating losses which would be subject to the time limitation if carried forward. The value of the tax expenditure is thus the amount of tax relief associated with the losses that would otherwise have been subject to the time limitations.

No data are available.

Federal/Provincial Financing Arrangements

Quebec abatement

Under the contracting-out arrangements which were offered to provinces in the mid-1960s for certain federal transfer programs, provinces could elect to receive part of the federal contribution in the form of a tax point transfer. Quebec was the only province to elect this arrangement at the time and this has resulted in a 16.5 percentage-point abatement of federal tax for Quebec residents.

Transfers of income tax room to provinces

In 1967, the federal government transferred tax points to all provinces in place of certain direct cash transfers under the cost-shared program for post-secondary education. As a result, the personal income tax abatement was increased by 4 percentage points. In 1977, an additional 9.5 percentage points of individual income tax were provided to the provinces in respect of post-secondary, hospital insurance, and medicare programs.

General Business and Investment

$100,000 lifetime capital gains exemption

The first $100,000 of lifetime capital gains realized by individuals was non-taxable. The exemption was available only to the extent that the gains exceeded cumulative net investment losses incurred after 1987. The costs of tax expenditures associated with capital gains realized on exempt qualified farm property and exempt qualified small business shares are listed separately, even though some of these gains would qualify for the $100,000 lifetime capital gains exemption.

The 1992 budget eliminated the exemption for real estate gains accruing after February 1992 on property not used in an active business.

(The 1994 budget proposed the elimination of the $100,000 lifetime capital gains exemption.)

Partial inclusion of capital gains

Only three-quarters of net realized capital gains are included in income.

Deduction of research and development expenditures

All research and development (R&D) expenditures may be deducted immediately, despite the fact that some of these expenditures may be capital in nature.

The estimates are calculated on the basis that 10 per cent of R&D expenditures are of a capital nature. In the absence of this R&D provision, these amounts would have been depreciated over several years (subject to CCA rules) rather than immediately. The proportion of R&D that is of a capital nature is estimated from Revenue Canada data. The estimate is based on the fact that R&D expenditures of a capital nature are deductible in the year the expenditures are made rather than over the lifetime of the capital equipment. However, it does not take into consideration the deduction that would otherwise be available in future years. Accordingly, it overestimates the true cost of the measure to the extent that CCA would otherwise have been deducted over the course of a number of years. A more detailed explanation is provided in Appendix B.

Deduction of limited partnership losses

A limited partner is able to deduct losses against other income up to the amount of investment at risk whereas a shareholder is normally not permitted to deduct corporate losses against personal income. Unused losses may be carried back three years or forward seven years and are deductible up to the amount of investment at risk.

Limited partnership losses arise from a range of investments, from real estate investments to certified film productions. It is estimated that 15 per cent of this tax expenditure is attributable to CCA claimed on Canadian films.

Investment tax credit

A tax credit is available for investments in research and development, exploration activities and certain regions. The tax credits ranged from 15 per cent to 45 per cent in 1991 and 1992. The estimates treat the full investment tax credit as a tax expenditure even though tax credits reduce the capital cost of assets for CCA purposes and the adjusted cost base for capital gains purposes. A more detailed explanation is provided in Appendix B.

Deferral through five-year reserve

If proceeds from a sale of capital property are not all receivable in the year of the sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds are received. A minimum of 20 per cent of the gain must be brought into income each year, creating a maximum five-year reserve period. Amounts brought back into income from reserves exceeded amounts set aside in newly-established reserves, giving rise to negative estimates for 1991 and 1992.

Deferral through capital gains rollovers

In certain circumstances, taxpayers may defer the reporting of capital gains for tax purposes. General business rollover provisions may be categorized into three groups:

Involuntary dispositions

Capital gains resulting from an involuntary disposition (e.g., insurance proceeds received for an asset destroyed in a fire) may be deferred if the funds are reinvested in a replacement asset within a specified period. The capital gain is taxable upon disposition of the replacement property.

Voluntary dispositions

Capital gains resulting from the voluntary disposition of land and buildings by businesses may be deferred if replacement properties are purchased soon thereafter (for example, a business changing location). The rollover is generally not available for properties used to generate rental income.

Transfers to a corporation for consideration including shares

Individuals may transfer an asset to a corporation controlled by them or their spouses and elect to roll over any resulting capital gain or recaptured depreciation into the corporation instead of paying tax in the year of sale.

No data are available.

Deferral through billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

$1,000 capital gains exemption on personal-use property

Personal-use property is held primarily for the use and enjoyment of the owner rather than as an investment.

In calculating the capital gain on personal use property, if the proceeds of disposition are less than $1,000, no capital gain needs to be reported. If the proceeds exceed this amount, the Adjusted Cost Base (ACB) will be deemed to be a minimum of $1,000, thus reducing the capital gain in situations where the true ACB is less than $1,000.

No data are available.

$200 capital gains exemption on foreign exchange transactions

The first $200 of net capital gains on foreign exchange transactions is exempt from tax.

No data are available.

Taxation of capital gains upon realization

Capital gains are taxed upon the disposition of property and not when they accrue. This provides a tax deferral.

No data are available.

Health

Non-taxation of employer-paid insurance benefits for group private health and dental plans

Employer-paid benefits for private health and dental plans, are not taxable.

The estimates are based on data from Statistics Canada and from an annual survey "Health Insurance Benefits in Canada", conducted by the Canadian Life and Health Insurance Association.

Disability credit

Canadians who are markedly restricted in the basic activities of daily living are entitled to a tax credit. The credits were 17 per cent of $4,118 for 1991 and $4,233 in 1992. Any unused amount of the credit may be transferred to a supporting person.

Medical expenses credit

Taxpayers are entitled to a 17-per-cent credit for eligible medical expenses incurred by the taxpayer, the taxpayer's spouse or by dependants. The credit was available in respect of expenses which exceeded the lesser of 3 per cent of net income or $1,570 in 1991 and $1,614 in 1992.

Income Maintenance and Retirement

The non-taxation of income-tested programs such as the guaranteed income supplement and provincial social assistance presents conceptual difficulties. The problems arise because, in many respects, these programs operate like an income tax in that eligibility for benefits is phased out after a certain income level. In this regard, excluding such benefits from income tax might not be considered a tax expenditure since they are subject to their own "tax". On the other hand, a broadly-based benchmark tax system would include such amounts in income. Given the comprehensive approach taken in this document, these items are considered to be tax expenditures.

Non-taxation of guaranteed income supplement and spouse's allowance benefits

The guaranteed income supplement (GIS) is an income-tested benefit payable to an old age security (OAS) pensioners. Spouses of OAS recipients (or widows/widowers) aged between 60 and 64 may be eligible for the spouse's allowance (SPA). Payments under both the guaranteed income supplement and the spouse's allowance programs are non-taxable. GIS and SPA benefits must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on data from the Human Resources Development Canada publication, *Statistics Related to Income Security Programs*.

Non-taxation of social assistance benefits

Social assistance payments received by low-income Canadians must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such assistance payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on data provided by Human Resources Development Canada.

Non-taxation of workers' compensation benefits

Workers' compensation payments must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

Prior to taxation year 1992, taxpayers were not required to report a distinct amount for workers' compensation benefits on their tax returns. For the first time, the 1992 estimate is based on workers' compensation benefits reported for tax purposes. The 1991 estimate is based on data provided by Human Resources Development Canada.

Non-taxation of certain income from personal injury awards

Where a person has suffered mental or physical injury and has received a personal injury award, the investment income earned on such an award is excluded from tax until the end of the year in which the person reaches the age of 21.

Non-taxation of employer-paid premiums for group term life insurance of up to $25,000

Employer-paid premiums for group term life insurance coverage of up to $25,000 per employee are not taxable.

(The 1994 budget proposed the elimination of the tax exemption for employer-paid premiums for group term life insurance of up to $25,000.)

Non-taxation of RCMP pensions/compensation for injury, disability or death

Pension payments, allowances and other compensation received in respect of an injury, disability or death associated with service in the Royal Canadian Mounted Police are non-taxable.

The estimates are based on Public Accounts data.

Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)

These amounts are not included in income for tax purposes.

The estimates are based on Public Accounts data.

Non-taxation of veterans' disability pensions and support for dependants

These amounts are not included in income for tax purposes.

The estimates for this item are based on Public Accounts data.

Treatment of alimony and maintenance payments

Payments by a taxpayer to a divorced or separated spouse are deductible to the payer and taxable in the hands of the recipient.

This treatment represents a tax expenditure because it departs from the benchmark system established for purposes of this report. Under this benchmark tax system, deductions are permitted only for expenses incurred in order to earn income and transfers from other individuals are not included in income.

The estimates for this item are computed as the value of the deduction to the payer less the tax collected from the recipient.

Age credit

Individual taxpayers aged 65 or over were entitled to claim a tax credit of 17 per cent of $3,387 in 1991 and $3,482 in 1992. Unused portions may be transferred between spouses.

(The 1994 budget proposed that the age credit be subject to an income test.)

Pension income credit

A 17-per-cent tax credit is available on up to $1,000 of certain pension income. The unused portion of the credit may be transferred between spouses.

Saskatchewan pension credit

Contributions to the Saskatchewan Pension Plan are deductible up to the lesser of $600 or the amount of unused RRSP room in a particular year.

Registered retirement savings plans/registered pension plans

The federal revenue forgone due to the provisions pertaining to registered retirement savings plans (RRSPs), registered pension plans (RPPs) and deferred profit sharing plans (DPSPs) is a function of three components: the deductibility of contributions to such plans; the non-taxation of investment income accrued within such plans, and the income inclusion of RRSP/RPP withdrawals which reduces the cost resulting from the previous two. Individuals benefit from a deferral of tax on amounts contributed and on investment income. Also, there is an absolute tax saving to the extent that the tax rate on withdrawals is below that faced at the time of contributions. As noted in the introduction, the estimates provided in the table are made on a current cash-flow basis. That is, they measure the impact on the deficit of the tax measure in each of the years under consideration. However, as noted in the 1994 Annual Report of the Auditor General, this could be supplemented by an estimate of the long-term costs of the measure. This possibility will be examined and reported on in next year's report.

In 1991, a new system of comprehensive limits on tax-assisted retirement saving took effect. Under this system, saving in RRSPs, RPPs and DPSPs is governed by a comprehensive limit of 18 per cent of earnings up to a dollar amount. In more detail, the limits for 1991 and 1992 were as follows:

- For defined benefit pension plans, the limits were the same as in 1990: that is, there were no fixed limits on employee contributions while employer contributions were restricted to the amounts necessary to fully fund the promised benefits. Annual benefits under these pension plans are limited to the lesser of $1,722 and 2 per cent of best average earnings for each year of pensionable service.
- For RRSPs, contributions were limited to 18 per cent of earned income for the preceding taxation year to a dollar maximum ($11,500 for 1991 and $12,500 for 1992), minus a Pension Adjustment (PA). The PA was based on RPP or DPSP benefits earned by plan members in the previous taxation year. For a money purchase RPP or a DPSP, the PA is simply the total contribution made by or on behalf of a plan member in the year. For a defined benefit RPP, the PA is a measure of the benefits earned in the year, calculated according to a prescribed formula.

In 1992, the federal government introduced the Home Buyers' Plan that allowed individuals to withdraw up to $20,000 from their RRSPs on a tax-free basis to purchase a home. Amounts withdrawn under the Home Buyers' Plan are to be repaid to the individual's RRSP on an interest-free basis over a period of fifteen years. Amounts that are not repaid are included in the individual's income for tax purposes. The impact of the Home Buyers' plan on the cost of RRSPs is expected to be small.

It should be noted that the RRSP/RPP estimates do not reflect a mature system because contributions currently exceed withdrawals. Assuming a constant tax rate, if contributions equalled withdrawals, only the non-taxation of investment income would contribute to the net cost of the tax expenditure. As time goes by and more retired individuals have had the opportunity to contribute to RRSPs throughout their lifetime, the gap between contributions and withdrawals will shrink and possibly even become negative. The upward bias in the current estimates can therefore be expected to decline.

The estimates may not reflect the benefit to a particular individual in any given year because the individual is typically either a contributor or withdrawer at a point in time but not both. In order to estimate the benefit to a particular individual one could calculate the difference in disposable income between a situation in which that individual invests in an RRSP/RPP and one in which that individual invests in a non-sheltered savings instrument.

Data used to estimate the value of these measures were taken from the personal income tax model, unpublished data from Statistics Canada, and from Statistics Canada publications Trusteed Pension Funds (Cat. 74-201) and Pension Plans in Canada (Cat. 74-401), as well as from the Bank of Canada Review.

Deferred profit-sharing plans

Employers may make tax-deductible contributions to a profit-sharing plan on behalf of their employees. These amounts are taxable in the hands of the employees when withdrawals are made from the plan. The employer's contribution cannot exceed the lesser of $3,500 per employee (less any contributions by the employer to an RPP in respect of the employee) or 20 per cent of the employee's earnings.

No data are available.

Non-taxation of up to $10,000 of death benefits

Up to $10,000 of death benefits paid by an employer to the spouse of a deceased employee is non-taxable.

No data are available.

Non-taxation of investment income on life insurance policies

The investment income earned on some life insurance policies is not taxed as income to the policy holder. Instead, for reasons of administrative convenience, insurance companies are subject to tax on such earnings.

(See Appendix B for a further description of this measure and estimates of the cost of the tax expenditure involved.)

Resource Sector

Deduction of resource-related expenditures

Individuals are entitled to deduct certain expenses associated with the exploration for, and development of, Canadian natural resources. These expenses are deductible if the taxpayer either engages directly in these resource activities or provides financing to a resource company which, in turn, "flows through" the tax deductions to the taxpayer.

A tax expenditure arises when a flow-through share investor is able to use deductions for exploration and development more quickly than would otherwise have been possible by the resource company that actually undertook these expenditures. However, the available data do not permit a separation of expenses which are flowed through to investors and those which are incurred directly by the taxpayers. Amounts incurred directly by individuals are considered current expenses for the purposes of earning income so that their deductibility does not constitute a tax expenditure. The estimates should therefore be interpreted as an upper bound.

Assistance for prospectors and grubstakers

Where a prospector or grubstaker disposes of mining property to a corporation in exchange for shares in that corporation, the tax liability is deferred until the subsequent disposition of the shares. At that time, only three-quarters of the amount for which the mining property was transferred to the corporation need be included in income.

Small Business

$500,000 lifetime capital gains exemption for small business shares

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption and the $500,000 lifetime capital gain exemption on qualified farm property have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains and this is the approach adopted in the benchmark system. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income. Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted from uncertain taxable capital gains in future years.

Labour-sponsored venture capital corporations credit

A 20-per-cent tax credit is available on amounts invested in Labour-Sponsored Venture Capital Corporations, to a maximum credit of $700 in 1991 and $1,000 in 1992.

Deferral through ten-year capital gain reserve

If proceeds from the sale of small business shares to children, grandchildren or great-grandchildren are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year creating a maximum ten-year reserve period. This contrasts with the treatment of most other property where the maximum reserve period is five years. In the years under review, amounts brought back into income from reserves exceeded amounts set aside in newly-established reserves, giving rise to negative estimates.

Stock options for CCPC employees

In addition to the general stock option tax treatment, employees of Canadian Controlled Private Corporations (CCPCs) receive a further deferral advantage since they need not include the calculated benefit in their income until they dispose of the shares. For other employees this amount must be included when the option is exercised.

No data are available.

Other Items

Non-taxation of income from War Savings Certificates/Victory Bonds

Income earned on these instruments is non-taxable.

The estimates are based on Bank of Canada data.

Non-taxation of capital gains on principal residences

Capital gains realized on the disposition of a taxpayer's principal residence are non-taxable. The capital gains were determined using Multiple Listing Service (MLS) housing prices, adjusted to include expenditures on capital repairs and major additions and renovations, obtained from Statistics Canada's Consumer Expenditure Survey. The holding period for principal residences was derived from 1981 Census data.

If these gains were to become taxable, consideration would also have to be given to providing a deduction for mortgage interest payments. Work is under way to determine the feasibility of developing an estimate of the cost of such a provision.

Estimates for this item are provided for both partial and full inclusion rates for capital gains.

Non-taxation of income from the Office of the Governor General

This income is exempt from personal income taxation.

Data were provided by the Office of the Governor General.

Charitable donations credit

A tax credit of up to 20 per cent of net income is available for donations made to registered charities. Donations in excess of the 20-per-cent limit may be carried forward for up to five years. The 20-per-cent restriction does not apply to certain gifts of cultural property. The credit is 17 per cent on the first $250 of total donations (including gifts to the crown) and 29 per cent on donations in excess of $250.

(The 1994 budget proposed that the threshold at which the 29-per-cent rate applies be reduced from $250 to $200.)

Gifts to the Crown credit

A tax credit is available for gifts to the Crown. The credit is 17 per cent on the first $250 of total donations (including charitable donations) and 29 per cent on donations in excess of $250. Unused contributions may be carried forward for up to five years.

(The 1994 budget proposed that the threshold at which the 29-per-cent rate applies be reduced from $250 to $200.)

Political contributions credit

A credit is available for donations to registered federal political parties. The credit is 75 per cent of the first $100 of contributions, 50 per cent on the next $450 of contributions and 33⅓ per cent on the next $600. The credit claimable in any year is $500.

Non-taxation of income of Indians on reserves

The income of Indians is exempt if located on a reserve.

No data are available.

Non-taxation of gifts and bequests

Gifts and bequests are not included in the income of the recipient for tax purposes.

No data are available.

Memorandum Items

Non-taxation of allowances for certain public officials

Members of Parliament (MPs), MLAs, Senators and some other public officials (such as elected municipal officials and judges) receive flat allowances for expenses incidental to their duties. These amounts are not included in income for tax purposes.

This provision is a memorandum item because it is not possible to distinguish the proportion of these allowances which is used for personal consumption and that which is for work-related expenses.

Data are available only for the non-taxable allowances provided to MPs, MLAs and Senators. This information is found in the publication *Canadian Legislatures*.

Non-taxation of allowances for diplomats and other government employees posted abroad

Diplomats and other government employees posted abroad receive a non-taxable income supplement to cover the additional costs associated with living outside Canada.

Estimates are based on information obtained from Treasury Board.

Child care expense deduction

A portion of child care expenses is deductible if incurred for the purpose of earning business or employment income, taking an occupational training course or carrying on research for which a grant is received. For 1991 and 1992, the deduction could not exceed the lesser of $4,000 per child if the child was under seven or was disabled, $2,000 per child between seven and 14 years of age, or two-thirds of earned income for the year. The deduction must generally be claimed by the spouse with the lower income. However, the higher-income parent may claim a deduction if the lower-income parent is infirm, confined to a bed or wheelchair, in prison, or attending a designated educational institution on a full-time basis.

Attendant care expense deduction

A disabled individual can deduct the cost of unreimbursed care provided by a part-time attendant, if such an expense is required to enable the individual to work. For 1991 and 1992, the deduction could not exceed the lesser of $5,000 or two-thirds of earned income for the year.

Moving expense deduction

All reasonable moving expenses (e.g., transportation, meals and temporary accommodations) are deductible from income if the taxpayer moves at least 40 kilometres closer to the place of employment. Moving expense reimbursements provided by employers are not included in income.

The estimates do not include non-taxable reimbursements received from employers.

Deduction of carrying charges incurred to earn income

Interest and other carrying charges, such as investment counselling fees and safety deposit box charges, incurred to earn business or investment income are deductible.

Some might consider the deductibility of such expenses to be a tax expenditure because of the tax deferral arising from the up-front deduction of expenses associated with the earning of income which will not be taxed until received possibly in future years. Others would hold that carrying charges are incurred for the purpose of earning income and therefore represent part of the benchmark income tax system.

Deduction of meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment is part of a package price which includes amounts not subject to the 80-per-cent limitation, for instance the fee for a conference, the taxpayer is required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation.

(The 1994 budget proposed a reduction in the deductible portion of meals and entertainment expenses to 50 per cent of their costs.)

Deduction of farm losses for part-time farmers

Individuals whose major source of income is not farming are allowed to deduct farm losses up to an annual maximum of $8,750 against other income.

Part-time farm losses which are not deductible in the current year may be carried back three years and forward ten years to deduct against farm or non-farm income. The estimates include the cost of these carry-overs.

Farm and fishing loss carry-overs

Farm and fishing losses may be carried back three years and forward ten years. Most other business losses may be carried forward seven years.

The only data which are available are prior years' losses carried forward to the current year. In this regard, the estimates do not include current year losses carried forward to the future or back to the past, nor do they include future losses carried back to the taxation year in question. The estimates also do not include losses carried over by part-time farmers.

Capital loss carry-overs

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. The estimates do not include current year losses carried forward to the future or back to the past nor do they include future losses carried back to the taxation year in question.

Non-capital loss carry-overs

Non-capital losses may be carried back three years and forward seven years to offset other income.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost estimates may understate the true amount of revenue forgone because they do not include current year losses carried forward to the future or back to the past nor do they include future losses carried back to the taxation year in question.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of ⅔ of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province. The mandatory nature of the tax paid to the provinces leads to the classification of this provision as expenses incurred to earn income.

The estimates are based on data from Revenue Canada.

Deduction of accelerated tax depreciation not reported elsewhere

The depreciation allowable for tax purposes is called capital cost allowance (CCA). It may be greater than true economic depreciation. A tax deferral may thus be created when the tax deductions in the early years of the life of an asset exceed the actual depreciation in the value of the asset. The difference is captured upon subsequent disposition of the asset.

The estimates are based upon a comparison of CCA and book depreciation. Since book depreciation does not necessarily represent the true economic depreciation, it is not possible to calculate the value of this measure with a high degree of accuracy. Consequently, this deduction is reported as a memorandum item. A more detailed explanation is provided in Appendix B.

Deduction of other employment expenses

Employee expenses are generally not deductible. However, specific employment expenses (e.g., automobile expenses incurred by self-employed individuals, cost of meals and lodging for certain transport employees, legal expenses paid to collect salary) are deductible in certain circumstances in the computation of income.

This provision is a memorandum item because it is not possible to distinguish the proportion of these expenses which is used for personal consumption and that which is incurred in order to earn income.

Deduction of union and professional dues

Union and professional dues are fully deductible from income.

The mandatory nature of these payments leads to their classification as expenses to earn income.

Unemployment insurance contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for unemployment insurance contributions. Employer-paid premiums are not included in income.

The mandatory nature of unemployment insurance contributions leads to their classification as expenses incurred to earn income.

Canada and Quebec Pension Plan contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for Canada/Quebec Pension Plan contributions by both employees and the self-employed. Employer-paid premiums are not included in income.

Again, since CPP/QPP contributions are mandatory, they are classified as expenses incurred to earn income.

Foreign tax credit

In order to avoid double taxation, a tax credit is provided in recognition of income taxes paid in foreign countries.

Dividend gross-up and credit

In order to avoid double taxation, dividends received from taxable Canadian corporations are "grossed-up" by a factor of one-quarter and included in income. A tax credit equal to 13.33 per cent of the grossed-up amount is then provided.

Basic personal credit

All taxpayers qualify for a basic personal credit equal to 17 per cent of $6,280 in 1991 and $6,456 in 1992.

Non-taxation of capital dividends

Private corporations may distribute the exempt one-quarter of any realized capital gains accumulated in their "capital dividend account" to their shareholders in the form of a capital dividend. This dividend is non-taxable. This measure is reported as a memorandum item since it contributes to the integration of the taxation of corporate and personal income.

No data are available.

APPENDIX B
DESCRIPTION OF CORPORATE INCOME TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a simplified reference. It should be noted that the explanations refer to the 1990 and 1991 taxation years. Since that time, a number of provisions have been altered. Some of the more significant changes to these provisions made since 1991 are indicated in the text.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the corporate income tax model, which is maintained by Revenue Canada. For example, certain estimates, such as the deductibility of carrying charges on land, were calculated using other data sources.

Tax Rate Reductions

The following items are measures that reduce the statutory tax rate faced by a corporation. They are tax expenditures because income is taxed at a rate other than the generally applicable tax rate.

Low tax rate for small businesses

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for a small business tax rate reduction, known as the small business deduction. This deduction lowers the basic federal tax rate on the first $200,000 of active business income of CCPCs by 16 percentage points – from 28 per cent to 12 per cent.

(The 1994 budget proposed changes that will make some large CCPCs ineligible for the small business benefit.)

Low tax rate for manufacturing and processing

A tax reduction is provided on Canadian manufacturing and processing (M&P) income not subject to the small business deduction. This reduction takes the form of a non-refundable credit on income earned and has the effect of lowering the tax rate on M&P income. In the period under review, the reductions from the general 28-per-cent rate were as follows:

For that portion of a corporation's taxation year between

July 1, 1989 – June 30, 1990:	3 percentage points
July 1, 1990 – June 30, 1991:	4 percentage points
July 1, 1991 – December 31, 1992:	5 percentage points

The amounts reported in the tables estimate the additional revenues that would have been collected by the government if M&P income had been taxed at the general corporate rate.

Low tax rate for credit unions

Although not a private corporation for most purposes, a credit union is eligible for the small business deduction (i.e. 16 per cent of its taxable income). A credit union with more than $200,000 of active business income may be eligible for a a deduction of 16 per cent of its taxable income where the total income of the corporation since 1971 is less than the corporation's "maximum cumulative reserve", which is equal to 5 per cent of amounts owing to members (including members' deposits and share capital). The purpose of this additional deduction is to permit a credit union to accumulate capital on a tax-preferred basis up to a maximum of 5 per cent of deposits and capital.

Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations

The branch tax is imposed on that portion of the income of non-Canadian corporations derived from the carrying on of business in Canada through a branch. The rate is 25 per cent, but this is frequently reduced by reciprocal tax treaties to 15 per cent or 10 per cent.

A corporation is exempt from the branch tax if it is:

(a) a bank;

(b) a corporation whose principal business is:

  (i) the transportation of persons or goods;

  (ii) communications;

  (iii) mining iron ore in Canada; or

(c) an exempt corporation such as a registered charity.

No data are available.

Exemption from tax for international banking centres

A prescribed financial institution's branch or office carrying on certain business in the city of Montreal or Vancouver may qualify as an International Banking Centre (IBC) and therefore be exempt from tax on its income. To qualify as an IBC under the Income Tax Act, the branch's income must be derived from accepting deposits and making loans to non-residents. This measure, introduced in 1987, is a tax expenditure because a financial institution can undertake business with non-residents through a Canadian permanent establishment without being subject to Canadian income taxes.

No data are available.

Tax Credits

The following measures are credits against federal taxes otherwise payable. They are considered to be tax expenditures because they provide credits to businesses which engage in a particular activity such as research and development or undertake an investment in a designated region of the country. The federal government forgoes revenue because tax credits can reduce federal revenues in two ways. They may be:

- used to offset federal income taxes otherwise payable; and
- fully or partially refundable for some CCPCs.

Investment tax credits (ITCs)

The Income Tax Act provides an ITC for:

- investment in eligible depreciable property that is used in certain regions of the country; and
- expenditures on Scientific Research and Experimental Development (SR&ED).

An ITC provides beneficial treatment to taxpayers, depending on their size, the region of the country in which they operate and the nature of their investment. The amount of the credit is calculated as a percentage of the cost of eligible expenditures. For taxation years 1990 and 1991, separate estimates are provided for the regional and SR&ED investment tax credits.

Corporations may reduce but, generally, not eliminate federal taxes payable by the amount of ITCs available on certain eligible expenditures. Three-quarters of a taxpayer's federal tax payable in a taxation year may be offset by ITCs. (This latter limitation was removed for taxation years commencing after 1993.) For CCPCs, a special rule permits the full offset of federal tax on their business income eligible for the small business deduction. The carry-forward period for unused credits is ten years. The surtax still remains subject to the three-quarters limitation. The carry-back period is three years.

Credits utilized or refunded reduce either the undepreciated capital cost of the asset for capital cost allowance (CCA) purposes or, in the case of SR&ED, the SR&ED pool. Credits earned in respect of a property acquired after January 1, 1990 and not immediately available for use may not become claimable until the property is available for use or has been held by the taxpayer for two years.

Refundability of ITCs

A qualifying corporation that cannot use ITCs in the current year because the credits earned exceed the amount that could be used to offset taxes otherwise payable can use the excess to obtain current year cash refunds of either 40 per cent or 100 per cent, depending on the type of eligible expenditure. A qualifying corporation for purposes of the refund is a CCPC

which, together with any associated corporations, had taxable income not exceeding $200,000 in the preceding year. These latter rules were modified in the 1993 and 1994 federal budgets.

For qualifying CCPCs, the refundability rate of ITCs that cannot be used in the year they are earned is generally 40 per cent. A qualifying CCPC may receive a 100-per-cent refund on its share of ITCs earned at the 35-per-cent rate in respect of up to $2 million of annual current SR&ED expenditures. All refunds reduce the amount of ITC for carry-over purposes.

Issues in calculating the value of ITCs

To maintain consistency with the other estimates in this document, the amounts reported in the table estimate the forgone revenue for the year in question from each ITC. In other words, the estimates show how much additional revenue would have been collected by the government in the year if the ITC had been eliminated in that particular year. To do this, the amount of ITCs used in the year had to be separated into two components: ITCs that were both earned and used in the year, and ITCs that were earned in prior years but used in the year. The former represents credits used from current year expenditures. Included in these estimates are the costs of any applicable refunds on ITCs earned. The latter item, ITCs earned in the past but not used until the current year, is itemized separately.

Another perspective on the revenue cost of each ITC is obtained by looking at the amount of ITCs earned in 1990 and 1991. This information is provided in the table below. However, it should be recognized that ITCs earned in the year are not necessarily used in the year – they may be used in a subsequent or previous year, subject to the carry-over rules. As a result, had the ITCs been eliminated, government revenues for the year would not have been higher by the amounts shown in the table below since it may take a number of years for ITCs earned in a year to be used by the taxpayer to reduce federal taxes.

Investment tax credits earned in the year

	1990[1]	1991
	(millions of dollars)	
SR&ED ITC[2]	1,018	1,069
Atlantic Canada ITC	119	184
Special ITC	43	85
Cape Breton ITC	4	4
Exploration Tax Credit	19	2

1 The 1990 figures in this table are based on final data and may differ from the figures in last year's edition of this document, which were based on preliminary data.

2 Of this amount, about $10 to $15 million may be attributed to the regional component (i.e. the additional 10 percentage points for SR&ED ITCs which are available for expenditures in Atlantic Canada).

Scientific research and experimental development investment tax credit

There are three tax credit rates; a general rate of 20 per cent, a 30-per-cent rate for the Atlantic provinces and the Gaspé, and an enhanced rate of 35 per cent for qualifying CCPCs – those with prior year taxable income less than $200,000. (As a result of a 1994 Budget proposal, the 30-per-cent rate will not be available after 1994.) The maximum amount of SR&ED expenditures that can earn ITCs at the 35 per cent in a year is $2 million.

Atlantic Canada investment tax credit (AITC)

The 15-per-cent ITC is available for qualified property in the Atlantic region: Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, the Gaspé region, and their associated offshore areas. (This rate will be reduced to 10 per cent after 1994.)

The AITC applies to eligible expenditures on new buildings, machinery and equipment employed in the following qualifying activities: farming, fishing, logging, mining, oil and gas, and manufacturing and processing.

The AITC is refundable at a 40-per-cent rate for qualifying CCPCs and individuals. It is not refundable for other taxpayers.

Special investment tax credit (SITC)

The ITC rate was 30 per cent in selected prescribed regions. (The February 1994 Budget eliminated the 30-per-cent Special ITC, effective as of 1995, subject to some grandfathering provisions.)

Eligible SITC areas are in all provinces including north-eastern British Columbia, north-western Alberta, northern Saskatchewan, most of Manitoba, northern Ontario, northern Quebec and the Gaspé region, and areas of Atlantic Canada.

Qualifying activities are defined under the Regional Development Incentives Act (RDIA) and its regulations, and generally include manufacturing and processing facilities located in a qualifying region with the exception of certain primary processing of natural resources.

Cape Breton investment tax credit (CBITC)

The Cape Breton credit was 45 per cent after 1988 and was applicable to eligible equipment acquired after May 23, 1985 and before 1993.

Exploration tax credit (ETC)

A 25-per-cent ITC was available for qualified Canadian exploration expenditures – these expenditures are incurred in respect of a well costing in excess of $5 million. Credits were earned on costs incurred between December 1, 1985 and December 31, 1990.

ITCs claimed in current year but earned in prior years

These are tax credits that were earned by corporations in previous years but not claimed until the current year. There is a revenue cost to the government when the credits are used by corporations to reduce federal taxes payable. While the aggregate amount of these credits is known, there is not enough information available to identify separately the amounts for each credit.

Political contributions tax credit

A credit is available for contributions to registered federal political parties. The credit is 75 per cent of the first $100 contributed, 50 per cent on the next $450 contributed and 33⅓ per cent on the next $600 contributed. The maximum credit is $500 and would be available when the taxpayer has contributed $1,150.

This measure constitutes a tax expenditure because political contributions are judged not to be incurred to earn income.

Exemptions and Deductions

The following exemptions and deductions are identified as tax expenditures because they deviate from the benchmark tax system.

Partial inclusion of capital gains

For 1990 and subsequent years, three-quarters of net realized capital gains accrued since 1972 are included in income. The cost of the tax expenditure is the amount of additional tax that would have been collected had the remaining one-quarter of the capital gains been included in income. However, this amount is likely an overestimate of the true amount of the cost of this tax expenditure. To the extent that the capital gains are from shares that have increased in value due to retained earnings, and which have already been taxed at the corporate level, the partial inclusion of the capital gains provides some relief from double taxation and, therefore, should be part of the benchmark tax system.

Resource allowance

Resource allowance in lieu of deductibility of provincial royalties

The tax system provides a resource allowance equal to 25 per cent of a taxpayer's annual resource profits (after operating costs and capital cost allowances, but before the deduction of exploration expenses, development expenses, earned depletion and interest expenses). The resource allowance is provided in lieu of the deductibility of Crown royalties, mining taxes and other charges related to oil and gas or mining production. The value of the tax expenditure is estimated by comparing the resource allowance to the actual Crown charges. In the benchmark tax system, the Crown royalties would have been fully deductible and a resource allowance would not be provided.

Deductibility of provincial royalties for the Syncrude project

Taxpaying participants in the Syncrude project are permitted to deduct both the resource allowance and provincial royalties (in this case, "joint venture" payments made to the province of Alberta in lieu of a royalty) in computing income subject to tax. This is accomplished through a remission order. Under the benchmark tax system, these taxpayers would be permitted to deduct only provincial royalties. The value of the tax expenditure is calculated as the value of the resource allowance deduction.

Deductibility of royalties paid to Indian bands

Royalties and lease rentals paid to Indian bands in respect of oil and gas leases on Indian reservations are considered to be Crown charges paid to Her Majesty in Right of Canada or of a Province in trust to the Indian band. Unlike non-deductible Crown charges, amounts paid to the benefit of an Indian band are generally deductible for federal income tax purposes. In addition to the deductible Crown charges, a resource allowance is earned on the resource profits net of the deductible Crown charges.

In the benchmark tax system, the Crown charges would be deductible, but no resource allowance would be earned. Therefore, the cost of the tax expenditure is the value to the taxpayer of the resource allowance deduction.

No data are available.

Earned depletion

Earned depletion was an additional deduction from taxable income of certain exploration and development expenditures and other resource investments. Taxpayers were entitled to earn an extra deduction of up to 33⅓ per cent of either certain exploration expenses or the costs of assets related to a new mine or major expansion. These deductions were generally limited to 25 per cent of the taxpayer's annual resource profits. As in the case of Canadian exploration expenses (CEE) or Canadian development expenses (CDE), earned depletion could be pooled, i.e. placed in a special account, and any remaining balance deducted in a future taxation year with no time limit on carrying forward these amounts.

Earned depletion and mining exploration depletion deductions were eliminated as of January 1, 1990. No additions to the earned depletion pool were permitted after December 31, 1989, but deductions can still be made on the basis of existing depletion pools.

Under the benchmark tax system, a deduction for earned depletion would not be available.

Deductibility of itemized charitable donations

Charitable donations made by corporations are deductible in computing taxable income. This deduction is limited to 20 per cent of net income but unused deductions may be carried forward for up to five years.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Gifts to the Crown

A corporation may deduct the full amount of any gift it makes to Canada or a province. Unlike charitable donations, the amount deductible is not limited to 20 per cent of net income. However, the deduction may not exceed the amount of income in a particular fiscal year. Amounts not deducted can be carried forward for up to five years.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Non-deductibility of advertising expenses in foreign media

Expenses for advertising in non-Canadian newspapers or periodicals or on non-Canadian broadcast media cannot generally be deducted for income tax purposes if they are directed primarily to a market in Canada. Deducting the cost of advertising in foreign periodicals or TV stations is not restricted if the advertising is to promote sales in foreign markets.

This treatment results in a negative estimate since the deduction of an expense incurred to earn income is denied. Under the benchmark tax system, advertising expenses in foreign media that were incurred to gain or produce income from a business or property would be deductible whether targeted at foreign or domestic markets.

No data are available.

Non-taxation of provincial assistance for venture investments in small business

Normally, government assistance received by a corporation is either included in the corporation's income or subtracted in computing the cost basis of the assets to which the assistance relates for capital cost allowance (CCA) purposes. There are a number of exceptions to this rule, including provincial assistance provided for venture capital investment under specified provincial programs. Under the benchmark tax system, this type of assistance would be included in the corporation's income or the cost basis of the assets would be reduced.

No data are available.

Deferrals

The tax expenditures in this section provide for a deferral of income taxes from the current to a later taxation year. They have been valued on a cash-flow basis, i.e. the forgone tax revenue associated with the additional net deferral in the year. The alternative way of valuing deferrals would be to calculate the value of the interest-free loan that is provided to the taxpayer when taxes are deferred to a later year.

The Canadian exploration expense (CEE), Canadian development expense (CDE), Canadian oil and gas property expense (COGPE), Canadian exploration and development expense (CEDE), and foreign exploration and development expense (FEDE) provide accelerated write-offs of a taxpayer's exploration and development expenditures as compared to the corresponding deductions appearing in financial statements. This section describes the accounting rules corresponding to CEE and CDE and makes an assessment of how the effective book write-off rate compares to the tax write-off rate. A separate discussion of CEDE and FEDE is not included because the amounts are relatively small. In the case of COGPE, the existing maximum deduction rate is generally similar to the depreciation rate of the oil and gas property for financial statement purposes.

The estimate of the total value of the above tax measures must be interpreted carefully. The ability of mining corporations and some junior oil and gas corporations to flow out CEE, CDE and COGPE to investors by establishing limited partnerships or by issuing flow-through shares affects the allocation of the cost of the tax measure between personal and corporate income taxes and among industry sectors.

Fast write-off for Canadian development expenses

All Canadian oil and gas development expenditures are classified as CDE and written off at a 30-per-cent declining balance rate. Development costs of mining companies are CEE for a new mine or an expansion of a mine and CDE for mines that have commenced commercial production. The costs of acquiring mining properties are generally treated as CDE. Unused expenditures are accumulated in a separate account known as the cumulative Canadian development expense (CCDE) account or pool. Any undeducted balances in the CCDE account need not be used within a certain period of time; they carry forward indefinitely.

Generally accepted accounting principles allow companies to depreciate exploration and development expenditures on either a "full cost" or a "successful efforts" basis. The full cost method means that all costs, productive and unproductive, are capitalized and amortized as the reserves are produced and sold. The successful efforts method means that only those costs which result in the discovery of reserves and which have a benefit in terms of future revenues are capitalized; other costs are expensed as incurred. Most Canadian-controlled companies use the full cost method, while those in Canada that are foreign-controlled usually use the successful efforts method.

The 30-per-cent declining balance rate for CDE is in excess of the effective write-off rate associated with the full-cost accounting method, whereby development expenditures are capitalized and amortized as oil and gas reserves are produced and sold. Whether or not the 30-per-cent rate is, in fact, accelerated depends on the life of the reserve being developed and on the rate of production of the reserve. For example, the 30-per-cent rate is accelerated in the case of most wells that generally have at least a 10-year life

span. The 30-per-cent rate is also in excess of the effective write-off rate associated with the successful efforts accounting method because most development costs result in future benefits and, therefore, are amortized as the oil or gas reserves are produced and sold. Consequently, the CDE provision gives rise to a deferral of tax.

Fast write-off for Canadian exploration expenses

Expenditures incurred in prospecting, exploring for or searching for minerals, oil or gas, or incurred to develop mineral resources in Canada are deducted for tax purposes at a rate of up to 100 per cent. These expenditures are recorded by the taxpayer in a separate account known as the cumulative Canadian exploration expense (CCEE) account and any remaining balance may be deducted in a future taxation year. There is no time limit on carrying forward these expenses.

For the taxation years under consideration, a corporation in the resource sector, known as a principal business corporation (PBC), must deduct any balance in its CCEE account to the extent of its income for that taxation year and may not use this deduction to create a non-capital loss. This deduction is optional for a non-PBC or individual, and may be used by these taxpayers to create a non-capital loss.

The accounting treatment of exploration expenditures was described under the section on Canadian development expenses.

The 100-per-cent write-off for tax purposes is more rapid than the amounts used for financial statement purposes which require the amortization of some of the expenditures. Thus, the fast write-off for CEE provides a deferral of tax.

Fast write-off for capital equipment used for SR&ED

Capital expenditures for SR&ED may be written off immediately in the year incurred. Under the benchmark tax system, expenditures that are capital in nature and thus designed to produce income in the future are depreciated over the period in which the income is expected.

The estimates are calculated on the basis that 10 per cent of SR&ED expenditures are of a capital nature. In the absence of this SR&ED provision, these amounts would have been depreciated over several years (subject to CCA rules) rather than immediately. The proportion of SR&ED that is of a capital nature is estimated from Revenue Canada data. The estimate represents the impact of expensing SR&ED expenditures of a capital nature in the year they are made.

Allowable business investment loss

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income.

Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to a capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted against uncertain taxable capital gains in the future.

Deductibility of carrying charges on land

Before 1988, carrying charges on vacant land and "soft costs" were capitalized and amortized over the life of the asset or deducted when related revenue was earned. There were two important exceptions to this rule. First, carrying charges on vacant land were fully deductible if the land was used as part of the business of selling or developing land. Second, land development corporations were not required to capitalize soft costs.

These exceptions were phased out over a five-year period starting in 1988 and ending in 1992. Consequently, 40 per cent of these costs remained fully deductible in 1990 and 20 per cent were fully deductible in 1991.

A deduction in respect of land carrying costs up to an amount equal to $1 million times the prescribed interest rate for the year has been available for small developers since 1988. This deduction must be shared by related companies.

Under the benchmark tax system, carrying charges and soft costs would generally be treated as part of the cost of the property and would be deducted when the property was sold.

Data on raw land reported on financial statements were used to estimate the cost of the tax expenditure. However, no data are available to estimate the small developers' deduction.

Available for use

Before 1990, taxpayers were allowed to claim CCA and ITCs in respect of property not yet producing income (i.e. property not in use). In many cases, this resulted in a significant mismatch of revenues and expenses, which gave rise to a tax deferral. This was a tax expenditure because taxpayers were allowed to claim deductions and tax credits on property before it was put in use.

As of 1990, taxpayers may claim CCA and ITCs on eligible property at the earlier of the time it is put in use or in the second taxation year following the year of acquisition. Consequently, for the 1990 and 1991 taxation years, the value of the tax expenditure was nil because the taxpayer would not be permitted to claim CCA and ITCs on property that was acquired but not yet available for use. Property that became eligible for CCA and ITCs by virtue of the two-year deferral rule could give rise to a tax deferral (and this would constitute a tax expenditure) in 1992, if the property was acquired in 1990.

Capital gains taxation on realization basis

Capital gains are taxed upon the disposition of property and not on an accrual basis. This treatment results in a tax deferral. Under the benchmark tax system, capital gains would be fully included in income as they accrue.

No data are available.

Expensing of advertising costs

Advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future. This treatment results in a deferral of tax. Under the benchmark tax system, the expenses would be amortized over the benefit period. While the benefits of advertising may extend beyond the current year, determining useful lives in most cases is not feasible.

Data are not available.

Cash basis accounting

Farming and fishing corporations may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues.

No data are available.

Flexibility in inventory accounting

Farm corporations using the cash basis method of accounting are allowed to depart from it with regard to their inventory. However, a discretionary amount, not exceeding the fair market value of farm inventory on hand at year-end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farm corporations to avoid creating losses which, if carried forward, would be subject to the time limitation. Thus the tax expenditure provides tax relief to the extent that the losses would otherwise have been subject to the time limitations.

No data are available.

Deferral of income

On grain sales

Farmers may make deliveries of grain before the year-end and be paid with a ticket that may be cashed only in the following year. The payment for deliveries of grain is included in income only when the ticket is cashed, thereby providing a deferral of taxes. Under the benchmark tax system, income would be taxed on an accrual basis.

No data are available.

On destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is rebuilt. Under the benchmark tax system, income is taxable when it accrues.

No data are available.

Holdback on progress payments to contractors

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g., 10 to 15 per cent) is often held back until the entire project is satisfactorily completed. The amount held back need not be brought into the income of the contractor until the project to which it applies is certified as complete, rather than when earned as would be required in the benchmark tax structure. Where a contractor, in turn, withholds an amount from a subcontractor, costs equal to the amount of the holdback are not considered to have been incurred by the contractor and are not deductible until paid. The net impact of these two measures on a given contractor's tax liability depends on the ratio of holdbacks payable to holdbacks receivable. If holdbacks receivable are greater than holdbacks payable, there is a deferral of tax. If holdbacks payable exceed holdbacks receivable, there is a prepayment of taxes.

Increases in net holdbacks receivable or decreases in net holdbacks payable result in a positive estimate of the cost of the tax expenditure. Increases in net holdbacks payable or decreases in net holdbacks receivable result in a negative estimate.

Deferral of tax from use of billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

International

Non-taxation of life insurance companies' world income

All Canadian corporations except Canadian multinational life insurers are taxed on their worldwide income. Canadian multinational life insurers are taxed only on their profits from carrying on a life insurance business in Canada using special rules in the income tax regulations.

The cost of this tax expenditure was estimated from tax returns and information available from the Office of the Superintendent of Financial Institutions.

Exemptions from non-resident withholding tax

Canada, like other countries, imposes a withholding tax on various types of income paid to non-residents. The basis for this tax rests on the internationally accepted principle that a country has the right to tax income that arises or has its source in that country. The types of income subject to non-resident withholding tax include: certain interest, dividends, rents, royalties and similar payments; management fees; estate and trust income, alimony and support payments; as well as certain pension, annuity and other payments.

Over time, as the benefits of freer trade in capital, goods and services have been increasingly recognized, countries including Canada have adjusted their tariff and tax structures to remove impediments to international transactions. Part of this adjustment has been the reduction of non-resident withholding tax on certain payments.

Canada's statutory non-resident withholding tax rate is 25 per cent. However, the rate is lowered and exemptions provided for certain payments through an extensive network of bilateral tax treaties. These rate reductions, which apply on a reciprocal basis, differ depending on the type of income and the tax treaty country.

The *Income Tax Act* also provides for a number of unilateral exemptions from withholding tax including: exemptions for interest payments on government debt; interest payments to arm's length persons on long-term corporate debt; interest payments to arm's length persons on foreign currency deposits with branches of Schedule I banks; and, royalty payments for the use of copyright.

Lower withholding taxes can reduce the cost to Canadian business of accessing capital and other business inputs from abroad. For example, a lower Canadian withholding tax on interest payments to non-residents can reduce the cost of accessing foreign capital in cases where foreign creditors raise the interest rate charged to cover payment for withholding tax.

Sufficient data are currently not available to allow for estimates of the value of tax expenditures associated with withholding tax exemptions. A detailed survey of withholding tax collections and exemptions is under way at Revenue Canada and it is anticipated that the results of this survey will be available for future issues of this publication.

Exemption of foreign shipping and aircraft companies from Canadian income tax

Non-resident shipping corporations engaged primarily in international traffic are treated as non-resident under the Income Tax Act. Similarly, by international agreement, non-resident incorporated airlines engaged primarily in international traffic are treated as non-resident. In both cases, the exemption applies only if the non-resident's home country gives Canadians a comparable exemption. The cost of the tax expenditure is then the Canadian tax that would otherwise be payable on profits related to their Canadian business.

No data are available.

Other Tax Expenditures

The following tax measures are not directly related to the corporate business sector in Canada.

Transfer of income tax room to provinces in respect of shared programs

In 1967, federal-provincial fiscal arrangements were altered. The federal government substituted a transfer of corporate income tax points for direct transfers to provinces under the cost-shared program for post-secondary education. The tax change involved an increase in the corporate income tax abatement rate from 9 to 10 percentage points, effectively reducing the federal corporate income tax rate at that time from 37 per cent to 36 per cent (the rate before the abatements was 46 per cent). This transfer of tax room has been included as a tax expenditure because it is a substitute for direct spending programs.

Interest credited to life insurance policies

Life insurance companies are taxed under the Investment Income Tax (IIT) at a rate of 15 per cent on net investment earnings attributable to life insurance policies.

The IIT interacts with the taxation of policyholders. The *Income Tax Act* divides life insurance policies into two categories: savings-oriented policies and protection-oriented policies.

Savings-oriented policies are those where the amount of money invested in the policy is large relative to the death benefit. A holder of a savings-oriented policy is subject to annual accrual taxation in respect of the net investment earnings credited to the policy. Net investment earnings reported by these holders are subtracted from the IIT tax base in order to avoid double taxation of net investment earnings.

In contrast, a holder of a protection-oriented policy is not subject to annual accrual taxation. Net investment earnings are taxed when the policy is surrendered or terminated (other than by death), or when paid out as policy dividends once the cumulative dividends exceed the total premiums paid under the policy. Net investment earnings that are taxable to holders of protection-oriented policies are also deductible from the IIT base.

Most of the cost of the tax expenditure relates to protection-oriented policies. This cost has three basic elements:

- differences between personal and IIT tax rates;
- timing differences (i.e. policies that are eventually taxed in the hands of policyholders); and
- permanent differences (i.e. policies that are held until the death of the insured).

Non-taxation of registered charities and other non-profit organizations

Registered charities and other non-profit organizations, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the charity or organization has income, mainly investment income or profits from certain commercial activities.

No data are available.

Income tax exemption for provincial and municipal corporations

Provincial Crown corporations and municipal corporations are exempt from income tax. Under the benchmark tax structure, such corporations would be taxable to the extent that they had taxable income.

No data are available.

Non-taxation of certain federal Crown corporations

While Federal Crown corporations are generally not subject to income tax, those Crown corporations that carry on significant commercial activities are taxable. It is possible, however, that some exempt corporations have income that would be taxable under the benchmark tax system.

No data are available.

Memorandum Items

Excess of tax depreciation over depreciation for financial statement purposes

Issues in calculating the cash-flow impact of the excess of tax depreciation over depreciation for financial statement purposes

Under the benchmark tax system, corporations would be permitted a deduction for the use of capital equipment equal to the economic depreciation rate. Since economic depreciation rates are difficult to estimate for many categories of assets, a practical alternative is to adopt the depreciation rates used by the corporations in their financial statements. These rates are accessible and follow accounting norms that generally make them similar to economic depreciation rates. That is, they represent the taxpayers' own estimates of the useful lives of their assets.

In keeping with the cash-flow concept for valuing tax measures in this report, the tax value of CCA provisions has been estimated in reference to the depreciation as recorded in taxpayers' financial statements. That is, the value of the forgone revenue arising from the CCA is equal to the difference between CCA claims and depreciation for financial statement purposes multiplied by the corporation's marginal tax rate. The figures reported in the tables show the change in federal tax revenues that would result if corporations had claimed depreciation for financial statement purposes instead of CCA in computing income for tax purposes. As discussed below, when CCA differs from depreciation for financial statement purposes, some but not necessarily all of this may represent a tax expenditure. There may be other reasons why there is a difference between depreciation for financial statement purposes and CCA that are unrelated to the existence of a tax preference, which is why this measure is classified as a memorandum item. Furthermore, the available data do not permit a separation of the tax expenditure component associated with this provision from the portion that is essentially part of the benchmark system.

Differences between CCA and depreciation for financial statement purposes

CCA may differ in several fundamental ways from depreciation for financial statement purposes. First, the CCA rates at which assets can be written off against income may be faster than the rates used in companies' financial accounts. As a result of tax reform in 1988, however, the number of asset classes that have accelerated depreciation rates was reduced significantly. Where fast write-offs are still available, the CCA system allows a larger deduction from income for the first few years after the property is acquired. During these initial years, this treatment results in lower taxable income and thus lower tax liability than if depreciation for financial statement purposes had been claimed. For later taxation years, however, depreciation for financial

statement purposes would be greater than that allowed for tax purposes. Thus, income for tax purposes in these later years would be higher than if depreciation for financial statement purposes had been used. On balance, there has been a deferral of taxes. In the case of growing firms with many assets, the larger CCA claims on the newer assets would always be sufficient to offset the smaller CCA claims on older assets, so that taxable income would be continually lower than it otherwise would be. In this case, the tax deferral becomes indefinite and would be equivalent to a tax reduction.

Second, the CCA rate may be less than the depreciation rate for financial statement purposes. An example of this situation could be rapidly depreciating equipment where the CCA rate has not kept pace with changes in technology, which quickly render some equipment obsolete. During the initial years, CCA would be less than depreciation for financial statement purposes and there would be a prepayment of taxes. During the later years, CCA would exceed depreciation for financial statement purposes and there would be a tax savings. If this situation arises, the estimate of the cost of the tax expenditure would be negative.

As a result of the static nature of the calculation used in this study, the amount of the tax preference arising from accelerated or deficient CCA rates cannot be identified. The calculation is made at a particular point in time (the 1990 or 1991 taxation year) and not over the entire life of the asset. For example, consider the case of an asset where an accelerated CCA rate is provided. Clearly, a tax preference is available since there is a deferral of tax over the lifetime of the asset. If we look at the difference between CCA and depreciation for financial statement purposes during one of the initial years of the asset's life, we would generate a positive estimate, which is the correct conclusion, although the actual amount would be incorrect from a lifetime perspective. On the other hand, if we were to perform the same calculation at a later year (i.e. when depreciation for financial statement purposes exceeds CCA) we would obtain a negative estimate, which would be incorrect.

The third difference between CCA claimed and depreciation for financial statement purposes is that taxpayers have discretion in choosing the amount of CCA to deduct in a year, subject to a maximum amount. If taxpayers do not have sufficient taxable income, they need not claim the CCA available to them in that year; they can wait for a future year. By doing so, taxpayers can avoid creating a tax loss, which is subject to a limited carry-over period during which it can be deducted (i.e. three years back, seven years forward). On the other hand, there is no time limit on using CCA. Consequently, observing tax depreciation that exceeds depreciation for financial statement purposes does not necessarily imply that a tax preference has been provided. For example, consider an asset where the CCA rate and the depreciation rate for financial statement purposes are identical. If a taxpayer does not deduct CCA in one year and then makes the deduction in subsequent years, the amounts claimed for tax and depreciation for financial statement purposes would be different in these years even though there is no tax preference associated with this asset. Viewed in this light, the discretionary nature of the CCA deduction

may be seen as another mechanism to carry over losses to future years. If differences arise between CCA and depreciation for financial statement purposes for loss carry-over reasons, these should not be considered to be tax expenditures.

The fourth difference between CCA claimed and depreciation for financial statement purposes arises from the pooling of assets into CCA classes. (There are some exceptions such as rental buildings costing at least $50,000, which are placed in a separate prescribed class.) Depreciation for financial statement purposes is determined by reference to each individual asset. If an asset that originally cost $100 has depreciated so that its current book value is $50, and it is sold for $70, at least in principle the $20 difference would be brought into income. However, under the CCA system, this asset would typically be grouped with other assets in a CCA class and the proceeds of a sale would serve to reduce the total undepreciated capital cost of the class. Generally, the effect of this pooling is that the $20 of unrealized recapture on the disposal of property is gradually brought into income as future CCA claims for the class are reduced accordingly. Thus, the recapture of any "excess" depreciation claim may be deferred well beyond the time of disposition of an asset. Similarly, there may be a corresponding deferral in the recognition of terminal losses when the asset is sold for less than its depreciated value.

Finally, tax depreciation and depreciation for financial statement purposes differ in their treatment of interest payments related to the acquisition of a capital asset. For accounting purposes, interest payments may be capitalized in the cost of the asset; for tax purposes, interest payments are generally expensed in the year they are incurred.

Specific provisions

The CCA rate exceeds depreciation for financial statement purposes in some cases. The more generous provisions for certain types of property are described below. Except for capital equipment used in scientific research and experimental development, specific valuations of these special provisions could not be made under the cash-flow method as depreciation for financial statement purposes cannot be attributed to the various CCA classes.

Manufacturing and processing assets (class 29, 39, 40)

Specified property used primarily in manufacturing and processing was depreciated over three years at a 25-per-cent, 50-per-cent, 25-per-cent straight-line rate in class 29, if acquired after November 12, 1981 and before 1988.

After 1987, most M&P machinery and equipment assets went into class 39, which has a depreciation rate that diminished in stages to a 25-per-cent rate calculated on a declining balance basis with a half-year rule. In 1990, the rate was 30 per cent, which declined to 25 per cent in 1991. Certain assets (primarily lift trucks and computers) acquired in the calendar year 1988 or 1989 were placed in class 40, where the CCA rate was 40 per cent in 1988 and 35 per cent in 1989. These assets acquired after calendar 1989 fall into class 10 at a 30-per-cent declining balance rate.

Vessels (class 7)

Vessels are generally included in class 7 and are subject to a maximum CCA rate of 15 per cent. Accelerated CCA on a straight line basis at a maximum rate of 33⅓ per cent of the capital cost of the property is available in respect of a vessel including furniture, fittings, radio communication equipment and other equipment if it was (a) constructed in Canada, (b) registered in Canada, and (c) not used for any purpose whatever before acquisition by the owner. For vessels acquired before July 14, 1990, this accelerated capital cost allowance was available only if the Minister of Industry, Trade and Commerce (now the Minister of Industry) certified that all the above conditions had been met. This certification requirement was withdrawn for acquisitions after July 13, 1990.

Offshore drilling vessels (class 7, 41)

Certain offshore drilling vessels qualify for an additional 15-per-cent CCA for an effective rate of 30 per cent, subject to the half-year rule. An offshore drilling vessel acquired after December 31, 1987 becomes a class 41 rather than a class 7 asset and is depreciated at 25 per cent.

Power-operated movable equipment (class 22, 38)

Such equipment designed for the purpose of excavating, moving, placing or compacting earth, rock, concrete or asphalt acquired after March 16, 1964 and before 1988 can be depreciated at a 50-per-cent CCA rate, subject to the half-year rule. Equipment acquired after 1988 is depreciated under class 38, at a 35-per-cent CCA rate in 1989 and 30 per cent after 1989.

Railway assets (class 35)

Railway cars acquired after May 25, 1976 qualify for class 35, which has a CCA rate of 7 per cent. Railway cars acquired on or before February 2, 1990 and not for rent or lease are eligible for an additional allowance of 8 per cent. The additional allowance is reduced to 6 per cent for cars acquired after February 2, 1990. Railway cars acquired before April 27, 1989 for rent or lease are eligible for an additional allowance of 8 per cent – diminished to 6 per cent over the 1990 to 1995 taxation years. The rate is reduced to 6 per cent for cars acquired after April 26, 1989.

Communication satellites (class 30)

Unmanned telecommunication space craft acquired before 1988 can be written off on a 40-per-cent declining balance basis subject to the half-year rule.

Retailer's point-of-sale equipment (class 12)

A 100-per-cent CCA rate is applicable for certain types of point-of-sale equipment acquired after August 8, 1989 and before January 1, 1993. In addition, the half-year rule does not apply to these purchases. The equipment must be acquired for use in a business selling goods or providing services to consumers that is carried on in Canada or for lease to another taxpayer for use by that taxpayer in such a business.

Application software (class 12)

A 100-per-cent CCA rate, with the half-year rule, is applicable for application software or a right or license to use application software acquired after May 25, 1976.

Certified Canadian films (class 12, 10(w))

Certified productions acquired before 1988 qualify for a CCA rate of 100 per cent (class 12). Certified productions acquired after 1987 become class 10(w) property and are depreciated at a 30-per-cent declining balance rate, but are not subject to the half-year rule when acquired. An additional allowance up to the remaining undepreciated capital cost of the film property is deductible against income from Canadian films.

Energy-efficient equipment (class 34)

Straight-line depreciation of 25 per cent, 50 per cent and 25 per cent is applicable to certain equipment used for the generation of electricity or the production or distribution of heat. The equipment has to meet certain criteria relating to more efficient use of fuels or the utilization of waste materials to be eligible and be certified by the Minister of Natural Resources. Qualifying equipment includes equipment designed to: produce heat derived primarily from the consumption of wood wastes or municipal wastes; produce electrical energy by using wind energy; or recover heat that is a by-product of an industrial process. Also included as qualifying equipment are: hydro-electric installations not exceeding 15 megawatts; certain types of co-generation equipment; and certain types of active solar heating equipment.

(Changes to this class were proposed in the 1994 budget.)

Water and air pollution control property (class 24, 27)

Assets which are acquired primarily for the purposes of abating water or air pollution at a site qualify as class 24 or class 27. These assets are eligible for a straight-line allowance of 25 per cent, 50 per cent and 25 per cent over three years. This special allowance for water and air pollution control equipment is applicable only to new property that is used in operations that were started before 1974 and have been continuously carried on since that time. The eligibility of such property, once established, can flow through corporate amalgamations and wind-ups.

(Changes to this class were proposed in the 1994 budget.)

Mining assets (class 28, 41)

Certain mining buildings, machinery and equipment acquired for use at a new mine or a major expansion of an existing mine may qualify for an accelerated CCA rate of up to 100 per cent. A 25-per-cent increase in a mine's capacity is generally considered to be a major expansion.

These mining assets were previously included in class 28, and depreciated at a 30-per-cent rate. For acquisitions after 1987, these assets are included in class 41, and depreciated at a 25-per-cent rate. In addition to the 25-per-cent allowance provided in class 41, a taxpayer owning such property and operating the mine may claim an addition allowance equal to the lesser of (1) the remaining undepreciated capital cost of property of the class, or (2) the income for the year from the new or expanded mine.

The following three items are parts of the tax system that provide some integration between the personal and corporate tax systems. The values of the following items are calculated as additional corporate taxes that would be owing if corporations and individuals were treated as separate tax units.

Refundable Part I tax on investment income of private corporations

As a method of integrating personal and corporate income taxes, a portion of the income taxes paid on investment income received by a private corporation (excluding deductible inter-corporate dividends) is refunded to a CCPC when this income is paid out to shareholders as dividends.

Refundable capital gains for special investment corporations

Capital gains realized by an investment corporation are taxed at the corporation level and the tax is accumulated in the "refundable capital gains tax on hand" account. The corporation uses this account to claim a capital gains refund when it distributes capital gains dividends to its shareholders. Since these dividends are capital gains distributions, they are taxed as capital gains in the hands of the shareholder and not as dividends.

Loss carry-overs

Loss carry-overs are part of the benchmark tax system because the cyclical nature of business income suggests that such income should be viewed over a number of years. The loss carry-over rules permit taxpayers to apply their losses against past or future income. Where available, the revenue estimates indicate how much revenue the government forgoes by allowing current year losses to be applied against income from past years.

Non-capital loss

A non-capital loss is a company's loss from business operations. Non-capital losses may be carried back three years and forward seven years to reduce or offset the corporation's taxable income.

Net capital loss

A net capital loss can arise from the disposition of capital property. This type of loss may be carried back three years and forward indefinitely but applied only against net capital gains that are taxable.

No data are available.

Farm losses and restricted farm losses

A taxpayer who operates a farming or fishing business can deduct, in the calculation of its net income, a loss incurred from its business operation. The unused losses of a given year may be carried back three years and forward ten years.

When the major source of income is not farming, the amount of losses deductible in the year is restricted to a maximum of $8,750 against other income. The unused losses, defined as the excess of the net farm losses over the farm losses deductible in the year are considered restricted farm losses. Restricted farm losses may also be carried back three years and forward ten years but only against farm income.

Data are not available to estimate the forgone revenue.

Meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment is part of a package price which includes amounts not subject to the 80-per-cent limitation, for instance the fee for a conference, the taxpayer is required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation.

(The 1994 budget proposed a reduction in the deductible portion of meals and entertainment expenses to 50 per cent of their costs.)

Large corporations tax

The large corporations tax (LCT) was introduced on July 1, 1989 as a tax on the Canadian capital of large corporations. The rate of tax in 1990 and 1991 was 0.175 per cent and 0.2 per cent respectively.

This tax ensures that all large corporations with more than $10 million of taxable capital employed in Canada pay some federal tax. Amounts paid under the large corporations tax (LCT) in 1990 and 1991 could be used to reduce the Canadian portion of the 3-per-cent corporate surtax.

Threshold

The $10 million capital deduction effectively exempts smaller corporations from the LCT as long as these corporations are not related to other corporations subject to the LCT. That is, the $10 million deduction must be shared amongst related corporations. This capital deduction is not considered to be a tax expenditure because it is generally available to all corporations.

Exempt corporations

Certain corporations such as non-resident investment corporations, deposit insurance corporations and corporations exempt from paying Part I income tax are exempt from paying the LCT. This exemption is a tax expenditure, but data are not available to estimate its value.

Patronage dividend deduction by credit unions and co-operatives

Patronage dividends (the excess of revenues over costs) paid out by a credit union or a co-operative to its members are deductible in computing the corporate income tax liability of credit unions and co-operatives. The taxpayer is required to withhold 15 per cent of all patronage dividends in excess of $100 paid to each customer who is resident in Canada.

The appropriate benchmark tax treatment of patronage dividends is uncertain. These dividends could be considered to be analogous to the payment of a volume discount or the return of excess payments. With this view of the benchmark system, this would not be a tax expenditure.

Alternatively, these payments could be perceived as the distribution to members of earnings which would not be deductible under the benchmark system. The amount shown, reflecting this view of the benchmark system, is the revenue impact of allowing patronage dividends to be deductible from income.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of ⅔ of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province. The mandatory nature of the tax paid to the provinces leads to the classification of this provision as expenses incurred to earn income.

Non-resident-owned investment corporation refund

A non-resident-owned investment corporation must pay income tax at a rate of 25 per cent. However, except for capital gains realized on taxable Canadian property, this tax is refundable when the surplus is distributed as taxable dividends to the shareholders and the applicable rate of withholding tax then applies. The refund is designed to relieve the dividends paid to non-residents from double taxation that would otherwise result. The corporation is essentially treated as a conduit for the flow-through of income. The amounts reported estimate the tax revenues that would be generated if the non-resident-owned investment corporation refund was not available.

Investment corporation deduction

Investment income is taxed at the corporation level and in the hands of the individual who receives it as dividend payments. In order to achieve a certain degree of integration between the personal and corporate tax systems, the current rules allow an investment corporation to deduct from its Part I tax otherwise payable 20 per cent of the amount by which its taxable income exceeds its taxed capital gains.

Deferral of capital gains income through various rollover provisions

The taxation of capital gains is affected by provisions that permit taxpayers to avoid realization for tax purposes through various rollover provisions. Rollovers associated with amalgamations and other corporate reorganizations have been considered part of the benchmark tax structure. Since the benchmark tax structure includes all accrued gains, this item is identified separately for information purposes. Examples include:

- the transfer of assets to a corporation or partnership in consideration for share capital or a partnership interest;
- amalgamations of taxable Canadian corporations;
- the winding-up of a subsidiary corporation into its parent corporation; and
- share-for-share exchanges.

(The 1994 budget proposed changes that will curtail the use of various rollover provisions in certain re-organizations.)

No data are available.

Excess deduction for intangible assets

Three-quarters of eligible capital expenditures on intangible assets is added to cumulative eligible capital. A deduction of up to 7 per cent of cumulative eligible capital at the end of the year is allowed. An example of intangible assets is goodwill purchased upon the acquisition of a business.

This treatment of intangible assets could give rise to positive or negative estimates depending upon the actual rate of depreciation relative to the amount that is permitted for tax purposes.

No data are available.

Tax exemption on income of foreign affiliates of Canadian corporations

The Canadian system for taxing the income of foreign affiliates of Canadian shareholders or the dividend income of the Canadian shareholders derived from foreign affiliates is based on the objectives of encouraging international competitiveness, protecting the tax base and eliminating double taxation.

Where the foreign affiliate earns active business income, Canada defers any recognition of that income until it is paid to the Canadian shareholders as a dividend on shares of the affiliate. In cases where the business income has been earned in a country with which Canada has a double taxation treaty, the dividend paid out of that income to Canadian corporate shareholders is not subject to additional Canadian tax. Where the business income is earned in non-treaty countries, the dividend is taxed in Canada but a tax deduction is provided to Canadian corporate shareholders based on the underlying foreign tax paid.

Where the foreign affiliate earns passive income and the affiliate is a controlled foreign affiliate of a person resident in Canada, the passive income is taxed in the Canadian shareholder's hands on an accrual basis. The Canadian shareholder can deduct taxes paid in the foreign jurisdiction in determining its net additional Canadian tax liability. When the income earned in the foreign affiliate is actually paid to the shareholder in the form of a dividend, a deduction from income subject to tax is provided to the extent that the income was included in income subject to tax in a previous year.

Questions arise as to what should be the appropriate benchmark system to measure the value of the tax expenditure, if any, in this case. Basically, three different benchmarks could be contemplated:

(a) **Canada should tax only Canadian-source income**. This is the territorial approach. Under this approach, foreign subsidiaries of Canadian companies would face the same tax burden on foreign-sourced business income as locally-owned enterprises in the foreign jurisdiction. This approach is consistent with the concept of capital-import neutrality. Capital-import neutrality results when the shareholders of subsidiaries do not face additional taxes in Canada with respect to the foreign business income earned by their subsidiaries. This is the approach that Canada has adopted with respect to dividends arising from affiliates in countries with which Canada has entered into a double taxation agreement. If this exempt dividend approach were to be considered as the benchmark, then no preference would be associated with the foreign dividend exemption.

(b) **Income earned by a foreign affiliate should be taxable in Canada when dividends are paid to the Canadian shareholder and double taxation alleviated with a foreign tax credit**. This is the approach used by a number of countries since it allows for additional taxes to be collected in the country of residence of the shareholder of a foreign affiliate at the time a dividend is paid to the shareholder by the affiliate out of foreign business income. These additional taxes would be levied when domestic tax payable exceeds the amount of foreign taxes paid both on the dividend itself and on the underlying foreign corporate profits out of which the dividend was paid. In Canada, dividends from foreign affiliates that do not qualify as exempt dividends are taxed on this basis. If this were to be considered the benchmark system, then the exempt dividend system would provide a preference, measured as the additional tax, net of the foreign tax credit, that would have been payable had the dividend been taxable in Canada.

(c) **Income earned by foreign affiliates should be taxable in Canada as it accrues to the Canadian shareholder, i.e. on a current basis**. This system is consistent with the concept of capital-export neutrality, which states that income of foreign affiliates should be subject to the same tax in the hands of its shareholders on a current basis regardless of whether the income is earned domestically or in a foreign affiliate. Certain passive income earned by controlled foreign affiliates is taxable on this basis in Canada. If this system were to be viewed as the benchmark, the foreign tax credit approach would be said to provide a preference measured as the deferral of incremental Canadian tax from the time the income is earned until the time the dividend is paid out.

Each of these three possible benchmarks has a policy justification. Data required to compute the amount of tax preference associated with any of the benchmarks are currently unavailable.

Categorization of Items by Industrial Category

To provide more information, an industrial breakdown of the major corporate tax measures has been included in the tables. Tax expenditures and their associated costs were redistributed across industries to reflect other information where available. The broad industry classifications are defined by the 1980 Standard Industrial Classification Code (SIC) and are indicated below:

Industry	Standard Industrial Classification Code
Agriculture, Forestry, and Fishing	0100 – 0599
Manufacturing	1000-3599, 3700 – 3999
Construction	4000 – 4499
Transportation and Storage	4500 – 4799
Communications	4800 – 4841
Public Utilities	4900 – 4999
Wholesale Trade	5000 – 5999
Retail Trade	6000 – 6999
Finance	7000 – 7699
Services	7700 – 7799, 8500 – 9999
Oil and Gas	0630 – 0799, 0910 – 0919, 3600 – 3699
Mining	0600 – 0629, 0800 – 0899, 0920 –0999
All Corporations	0000 – 9999

APPENDIX C
DESCRIPTION OF THE GOODS AND SERVICES TAX PROVISIONS

Since the Goods and Services Tax (GST) is levied at all points in the production and distribution chain, the value-added nature of the tax makes it equivalent to a retail sales tax levied on the sale of goods and services to the ultimate consumer. Based on this equivalency, the GST base can be estimated using Statistics Canada's National Accounts and input-output tables.

National Accounts data provide the level of personal expenditures and the expenditures of public sector bodies. In the case of personal expenditures, detail is published for 40 types of expenditures covering durables, semi-durables, non-durables and services. The expenditures of public sector bodies cover the federal government, provincial governments, municipalities, universities, school boards, public colleges, hospitals, charities and non-profit institutions.

The input-output tables provide the data by detailed commodities which comprise each of the expenditure categories described above. These commodity breakdowns are used to identify the impact of the GST provisions which either zero-rate or exempt certain goods and services. It is not possible to use the National Accounts and the input-output tables to estimate the costs of all the tax expenditures associated with the GST. In some cases, modifications had to be made to the estimates derived from the National Accounts and input-output table data. In other cases, actual data from Revenue Canada were used for the tax expenditure estimates, and certain estimates were derived from entirely different sources. This appendix describes the various GST tax expenditure estimates and how they were derived.

Zero-Rated Goods and Services

Basic groceries

Basic groceries, which include the majority of foodstuffs for preparation and consumption at home, are zero-rated under the GST. However, the tax is charged on certain goods such as soft drinks, candies and confections, and alcoholic beverages.

The cost of the tax expenditure can be estimated by using input-output data and the National Accounts to identify commodities purchased by final consumers and public sector bodies which are currently not subject to tax. The majority of these purchases are contained in the category "Food and Non-Alcoholic Beverages".

Prescription drugs

Drugs that are controlled substances for which a prescription is required are zero-rated. This provision also includes other drugs that have been prescribed by a recognized health care practitioner. The associated dispensing fee is also zero-rated. However, this provision excludes those items labelled or supplied for veterinary use.

The estimate is derived from National Accounts and input-output tables. However, an adjustment is made to reflect the fact that the input-output commodity “Pharmaceuticals” includes both prescription and non-prescription medicine. The ratio used to separate these two categories of medicine is based on information provided by Health Canada.

Medical devices

A wide range of medical devices is zero-rated under the GST. Included in this provision are canes; crutches; wheelchairs; medical and surgical prostheses; ileostomy and colostomy devices; artificial breathing apparatus; hearing and speaking aids; prescription eyeglasses and contact lenses; various diabetic supplies; and, selected devices for the blind and for the hearing or speech impaired. In some instances, a device qualifies for tax-free status only if it is prescribed by a recognized health care practitioner.

The estimate is based on National Accounts and input-output tables. The zero-rated medical devices are found in the input-output commodities “Personal Medical Goods”, “Medical and Dental Equipment and Supplies”, and “Ophthalmic Goods”. It should be noted that all of the expenditures made by final consumers on these commodities are assumed to be zero-rated even though a small portion of these expenditures are, in fact, ineligible for tax relief. However, no adjustment is made to this estimate due to limited information.

Agricultural and fish products and purchases

Instead of taxing sales and providing input tax credits at early stages in the food production-distribution chain, this provision zero-rates certain agricultural and fish products all through the chain. A prescribed list of such supplies includes farm livestock, poultry, bees, grains and seeds for planting or feed, hops, barley, flax seed, straw, sugar cane or beets, etc. In addition, prescribed sales and purchases of major types of agricultural and fishing equipment are zero-rated.

The main effect of this provision is on the cash-flow position of taxpayers. For example, in the normal operation of the GST, farmers would pay the GST on taxable purchases and would claim a corresponding input tax credit at the end of their tax period. However, in the case of prescribed zero-rated supplies, the farmer does not pay the GST and so does not have to wait to claim an input-tax credit. Consequently, the cash-flow position of the farmer is improved. At the same time, however, the suppliers lose the benefit of holding the GST on these purchases until the end of their tax period. Since the aggregate tax liability of these taxpayers remains unchanged, the revenue implications of this measure are small.

Certain zero-rated purchases made by exporters

This provision zero-rates certain supplies of goods and services delivered in Canada but subsequently exported. These include:

- the supply of a good to a recipient who intends to export the property, provided it is not an exciseable good (spirits, beer or tobacco) and the good is not further processed or modified in Canada by the recipient;
- a supply of an exciseable good to a recipient who, in turn, exports the goods in bond;
- a supply of natural gas made to a person who is exporting the gas by pipeline and not further processing or using the gas in Canada before its exportation other than as fuel or compressor gas to transport the gas; and
- goods sold to duty free shops licensed as such under the *Customs Act*.

As with agricultural and fish products, this provision has only cash flow implications. Again, the impact of this measure on tax revenues is small.

Non-taxable importations

Certain importations are tax-free under the GST. These importations include goods, other than books and periodicals, valued at not more than $20 and mailed to residents of Canada from other countries. This provision also applies to duty-free personal importations such as goods valued at not more than $300 and imported by Canadians who have been outside the country for more than seven days, as well as goods imported by foreign diplomats.

No data are available.

Tax Exempt Goods and Services

Long-term residential rent

Rentals of a residential complex (such as a house) or a residential unit (such as an apartment) for a period of at least a month are tax exempt. Short-term accommodation is also exempt where the charge for the accommodation is not more than $20 per day.

The estimate is based on the GST being applied on the commodity "cash rent" contained in the input-output tables, and incorporates the loss of the GST currently paid on business inputs purchased by the landlord.

Health care services

Health care services are exempt under the GST. These services include the following categories:

- **institutional health care services provided in a health care facility.** These include accommodation, meals provided with accommodation, and rentals of medical equipment to patients or residents of the facility. However, it excludes meals served in a cafeteria, parking charges, or haircuts for which a separate fee is charged.
- **services provided by certain health care practitioners who must be licensed or otherwise certified to practise the particular profession in provinces.** This category includes services such as optometric, chiropractic, physiotherapy, chiropodic, podiatric, osteopathic, audiological, and psychological services. It also includes speech therapy and occupational therapy.
- **services covered by a provincial health insurance plan.** Most of these services are already covered by the previous two provisions.

All those exempt services which are covered by provincial health insurance plans are included in the benchmark because, Constitutionally, the GST cannot apply to purchases made by provincial governments. Thus, the only cost from this provision involves health services purchased by final consumers. The estimates for this provision are based on National Accounts and input-output data.

Education services (tuition)

The GST provides an exemption for most educational services. The exemption includes tuition fees paid for courses provided primarily for elementary or secondary school students; courses leading to credits towards a diploma or degree awarded by a recognised school authority, university or college; and certain other types of training for a trade or vocation. In addition, the exemption covers meals supplied to elementary or secondary students as well as most meal plans at a university or public college.

The estimate is derived from the revenues that would be collected if tuition fees were taxed and input tax credits were allowed for taxable purchases. The estimate takes into account the fact that universities and public colleges currently receive a rebate of 67 per cent of the tax that they pay on their purchases.

The estimate is based on the input-output commodity “Education Services” as well as data contained in Statistics Canada’s publication “University Finance Trend Analysis”.

Child care and personal services

Certain child and personal care services are exempt under the GST. The exemption covers the following:

- child care services provided for periods of less than 24 hours to children under 14 years of age;
- certain personal care services including supplies of care and supervision to residents of an institution, as well as accommodation where it is provided for children or disabled or underprivileged persons.

The estimate is derived from the input-output commodity “Personal Services, including Child Care” contained in the final demand category “Domestic and Child Care Services”. The estimate reported here is understated because it does not account for day-care which might be paid by the government, or day-care provided by a non-profit organization that could be eligible for a GST rebate.

Legal aid services

Legal services provided under a provincially authorized legal aid program are exempt under the GST. This includes payments by the client in respect of the legal aid services and payments by a legal aid society to a private lawyer for legal services.

There are two ways in which the tax is relieved:

- legal aid services delivered directly by the Crown or a Crown agency (as is the case in Nova Scotia, Newfoundland, Prince Edward Island, Manitoba, and Saskatchewan) are exempt;
- legal aid provided by private practitioners to a legal aid plan administrator are taxable. However, the person responsible for the legal aid plan is entitled to a rebate of 100 per cent of any tax paid on the supply.

Revenue Canada supplied the data related to the rebates provided to legal aid plans in the provinces of New Brunswick, Quebec, Ontario, Alberta and British Columbia. To account for the other provinces where the service is explicitly exempt, provincial economic account data are used. Specifically, it is assumed that the value of legal aid services relative to the total expenditures contained in the provincial economic account category “Personal Business” in the tax-exempt provinces would be the same as in those provinces where a rebate is provided.

Ferry, road and bridge tolls

International ferry services are treated as zero-rated like other international transportation services. Other ferry, road and bridge tolls are exempt under the GST.

The estimate is derived from the input-output tables based on the expenditures of final consumers on the commodity "Highway and Bridge Maintenance".

Municipal transit

Municipal transit service is defined as a public passenger transportation service provided by a transit authority whose services are at least 90 per cent within a particular municipality and its surrounding areas. These municipal transit services are exempt under the GST.

The estimate is based on National Accounts and input-output tables.

Exemption for small businesses

Businesses or individuals with annual sales of $30,000 or less from taxable and zero-rated transactions may elect to be exempt under the GST. Such firms would not have to charge tax on their sales and would not be able to claim input tax credits on their business purchases.

The estimate is based on gross sales contained in the personal and corporate income tax models. From this data, one can estimate that the total sales from firms with annual sales of less than $30,000 accounts for approximately 0.5 per cent of all sales in the Canadian economy. This ratio can then be applied to the total gross GST collections to approximate the revenues which would arise from eliminating the small business threshold.

Quick method accounting

Small businesses registered under the GST are eligible to elect to account for GST using Quick Method Accounting. Under the scheme, businesses do not have to keep track of the tax paid on most of their inputs. Instead, these firms remit a prescribed percentage of the GST which they collect on their sales. The remaining GST collected is kept by the firm in lieu of the unaccounted input tax credits. The firm is eligible to claim an input tax credit for the tax paid on capital goods.

The estimate is derived from micro-statistical data supplied by Statistics Canada. The take-up rate of this provision for eligible small businesses is about 22 per cent.

Water and basic garbage collection services

Charges levied for water and basic garbage collection services are captured in the commodity "Water, Waste Disposal and Other Utilities" contained in the input-output tables. The estimate is based on expenditures on this commodity in the input-output tables and National Account data.

Domestic financial services

Financial services are defined to include services relating to financial intermediation, market intermediation and risk pooling. However, in many cases, the price of a financial service is implicit. For example, when banks provide lending and deposit taking services, the bank's fee for these services is the spread between interest rates received from borrowers and the interest paid to depositors. The exact price associated with each financial transaction is difficult to determine and, therefore, it is difficult to apply the GST to the sale of the service. As a result, most financial services provided to residents of Canada are exempt under the GST.

The GST also permits corporations to elect to be treated as "closely-related" if there is at least 90 per cent common ownership. The purpose of this provision is to allow for grouping only in those situations where the members of the group operate, for all intents and purposes, like a single company. As a result, members of a closely-related group which contains a listed financial institution may make an election that deems supplies of services and property made between them to be exempt financial services.

Data are not available.

Exempt supplies made by non-profit organizations

The exempt goods and services supplied by non-profit organizations include recreational services provided primarily to children aged 14 and under; recreational services provided to the underprivileged or disabled; supplies of food, beverage and lodging to relieve poverty or distress of individuals; and certain amateur performances.

No data are available.

Tax Rebates

Rebates for municipalities

Recognised municipalities are entitled to a rebate of 57.14 per cent of the GST paid on their purchases used in the course of supplying exempt municipal services.

The estimate is based on data from Revenue Canada.

Rebates for hospitals

Public hospitals are eligible for a rebate of 83 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for schools

Elementary and secondary schools, operating on a not-for-profit basis, are eligible for a rebate of 68 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for universities

Universities which are recognised degree-granting institutions operating on a not-for-profit basis are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for colleges

Public colleges which are funded by a government or municipality and whose primary purpose is to provide vocational, technical or general education are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for charities

Charities registered under the Income Tax Act are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for non-profit organizations

The organizations eligible for this rebate are government-funded non-profit organizations. They include registered amateur athletic associations and organizations operating a facility or part thereof to provide nursing home intermediate care or residential care, which receive at least 40 per cent of their funding from governments, municipalities or Indian bands. These organizations are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Housing rebate

Purchasers of newly-constructed residential dwellings and substantially-renovated houses are eligible for a rebate of the GST paid if the purchaser is acquiring the dwelling as a primary place of residence. For houses priced at or below $350,000, the rebate is 36 per cent of the total GST paid. The rebate is phased out for houses priced between $350,000 and $450,000.

The estimate is derived from the data on the value of residential housing contained in the National Accounts as well as the detailed newly constructed housing data contained in the Starts and Completions Survey conducted by Canada Mortgage and Housing Corporation.

Rebate to foreign visitors on accommodation

Non-residents visiting Canada are entitled to a rebate for the GST paid on most goods and short-term accommodation. Specifically, the rebate covers:

- goods for use primarily outside Canada, excluding exciseable goods such as alcoholic beverages and tobacco products, provided the goods are exported within 60 days of purchase;
- the tax paid on short-term lodging, but not including meals, where the period of stay is less than one month;
- the total tax paid must be at least $20.

However, goods for use outside Canada are essentially the same as other exported goods and should be considered as part of the benchmark. Thus, the cost of to this provision is only the rebate associated with short-term accommodation.

The estimate is based on data from Revenue Canada.

Special credit for certified institutions

A special credit is provided in the period from January 1, 1991 to the end of 1995 to certified institutions which employ mentally or physically disabled individuals in the manufacturing of goods. These institutions are treated in the same manner as other businesses under the GST. However, they receive a special credit calculated on the basis of 100 per cent of the GST collected from sales on manufactured goods in 1991, 75 per cent in 1992, 50 per cent in 1993 and 25 per cent in both 1994 and 1995.

No data are available.

Tax Credits

Small business transitional credit

A transitional credit was provided to small business GST registrants whose taxable sales in any three-month period beginning in 1990 or in their first full quarter of 1991 did not exceed $500,000. The maximum credit was $1,000. It was calculated as $300 plus 2 per cent of taxable sales over $15,000 in any quarter beginning January 1990 and before April 1991. The estimate is calculated from the GST returns received by Revenue Canada.

The GST credit

As part of the introduction of the GST, a GST Credit was established to ensure that families with annual incomes below $30,000 would be better off under the new sales tax regime. The amount of the GST Credit depends upon family size and income. The basic adult credit was $190 a year in 1991. Families with children 18 years and younger received a basic child credit of $100 for each child. However, single parents could claim a full adult credit of $190 for one dependent child. In addition to their basic credit, single adults (including single parents) were eligible for an additional credit of up to $100. The value of the credit was reduced for families with income of over $24,769 in 1990. Both the credit amounts and the income threshold are adjusted annually to increases in the consumer price index in excess of 3 per cent.

The estimate is based on data from Revenue Canada.

Memorandum Items

Meals and entertainment expenses

In the normal operation of the GST, registrants are allowed to claim full input tax credits for the tax paid on their purchases. However, in the case of the tax paid on meals, beverages and entertainment expenses, the registrant is allowed to recover only 80 per cent of the GST paid as an input tax credit. There is no input tax credit allowed for the GST paid on membership fees or dues in any club whose main purpose is to provide dining, recreational or sporting facilities.

(The 1994 budget proposed that the input tax credit for business meals and expenses be reduced from 80 per cent to 50 per cent for purchases made after February 1994.)

The estimate is based on the cost of the meals and entertainment tax expenditures contained in the Personal and Corporate Income Tax Expenditure tables. These figures are first grossed up to arrive at the total meals and entertainment expenses in the entire economy using the marginal federal income tax rates by sectors. Then, 15 per cent is removed to account for expenses incurred in GST-exempt activities since they are ineligible for any input tax credits. The cost of this provision is equal to the above net expenses multiplied by 7 per cent.

Rebate to employees and partners

A rebate is available to certain employees of a GST registrant for the GST paid on those expenses that are deductible in computing the employee's income from employment for income tax purposes. For example, the employee is allowed to claim a rebate equal to 7/107ths of the capital cost

allowance on an automobile, aircraft or musical instrument that is used in his or her employment and on which GST is payable. Also, the GST rebate is available to an individual who is a member of a GST-registered partnership in respect of expenses incurred outside the partnership that are deducted in computing the member's income from the partnership for the purposes of the *Income Tax Act*.

The estimate is based on data from Revenue Canada.

Sales of personal-use real property

The sale of personal-use real property by an individual or a trust (all the beneficiaries of which are individuals) is exempt under the GST. Examples include the sale of used owner-occupied homes and country properties kept for personal use. However, the exemption does not include real property that is sold in the course of a business.

No data are available.

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Tax Expenditures

1995

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Introduction

The purpose of this report is to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada's federal income tax system and the Goods and Services Tax (GST). It is also an important input into the process of evaluating the operation of these tax systems. However, it should be emphasized that this report itself does not attempt to make judgements about either the appropriateness of government policy objectives or the effectiveness of the various tax provisions in achieving those objectives.

The principal function of taxes is to raise the revenues necessary to finance government operations. In addition, tax measures are often used to implement government policy objectives by providing assistance or incentives to particular groups of individuals, businesses or to certain types of activities. These measures, which can take the form of tax exemptions, deductions, deferrals or credits, are typically referred to as tax expenditures. This document provides estimates of the cost of these items for the personal income tax system for the years 1992 and 1993, and the corporate income tax system for the years 1991 and 1992. It also provides estimates of the costs of tax expenditures associated with the GST for the years 1992 and 1993.

In order to identify tax expenditures, it is necessary to establish a "benchmark" tax structure which does not contain any preferential tax provisions. Tax expenditures are then defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the definition of the benchmark tax system, and hence what constitutes a tax expenditure. For example, child care expenses could be considered to be a cost of earning income and therefore part of the benchmark tax system but, if they are regarded as personal consumption, then tax assistance for child care expenses would be a tax expenditure.

This report takes a broad approach – only the most fundamental structural elements of each tax system are considered to be part of the benchmark. By defining the benchmark in this manner, many tax provisions are treated as tax expenditures. This approach provides information on a full range of measures, and so allows readers who take a different position as to the appropriate benchmark system to construct their own list of tax expenditures.

There are several tax provisions identified in the document that are not generally considered to be tax expenditures even though they reduce the amount of revenue collected. These measures are denoted as "memorandum items" and have been included to provide additional information. Three types of memorandum item are included.

- Measures that are considered to be part of the benchmark system. The dividend tax credit, for example, reduces or eliminates the double taxation of income earned by corporations and distributed to individuals through dividends.

- Measures where there may be some debate over whether the item should be considered to be a tax expenditure. The cost of business-related meals and entertainment, for example, may be considered to be an expense incurred in order to earn income (and therefore part of the benchmark) or may be considered to provide a significant element of personal benefit (and therefore constitute a tax expenditure).
- Measures where the available data do not permit separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. For example, a portion of tax-free allowances for MPs is used to cover legitimate employment expenses (and is therefore part of the benchmark for the income tax system) while the rest may be used for personal consumption (and is therefore an income tax expenditure). Since it is not possible to distinguish between these two elements, the non-taxation of such allowances is included as a memorandum item.

The federal government collects personal income taxes on behalf of the provinces (other than Quebec) which levy their income taxes as a percentage of basic federal tax. It also collects corporate income taxes on behalf of seven provinces (the exceptions are Quebec, Ontario, and Alberta), which use the same taxable income base as the federal government but levy taxes at their own rates. While there are provincial costs associated with the income tax measures examined in this report, the estimates do not incorporate these effects.

Similarly, changes in the GST base can affect provincial revenues. For example, the Atlantic provinces and Quebec levy their sales taxes on a base which includes the GST. In addition, since July 1992, Quebec has substantially harmonized its tax base with the GST. However, changes in the federal tax base would not affect Quebec revenues without a specific change in provincial legislation. As with the income tax measures, the estimates for the GST tax expenditures in this report reflect only federal impacts.

Tax expenditure documents published prior to tax reform provided estimates for personal, corporate and commodity taxes. Phase one of tax reform came into effect in 1988, resulting in a major overhaul of the personal and corporate income tax systems. Many tax expenditures were eliminated, reduced, or, in the case of personal taxes, changed from deductions to credits. Tax reform affected not only the number of tax expenditures, but also their revenue impacts because it changed the rate structure against which they are calculated. The second phase of tax reform replaced the manufacturers' sales tax with the GST, effective January 1, 1991. Because of the significant changes in the tax structure throughout these reforms, no estimates were released during this transitional period.

In December 1992, the first post-reform report, Government of Canada Personal Income Tax Expenditures, was issued. This report covered only personal income tax expenditures for the years 1988 and 1989 because of the lack of statistical information on the newly introduced GST and lags in the

receipt of post-1988 tax reform data for corporations. While preliminary post-reform data for the 1988 taxation year were available for corporations, they did not accurately reflect the impact of tax reform because of the transitional measures in the package and the carry-over of accelerated deductions and credits from previous years.

In December 1993, the second post-reform report was issued. This report covered the personal income tax system for the years 1989, 1990 and 1991, and the corporate income tax system for the years 1989 and 1990. The third post-reform tax expenditure report was published in December 1994. That report provided information on the personal income tax system for the years 1991 and 1992; the corporate income tax system for the years 1990 and 1991; and the GST for the years 1991 and 1992.

The first part of the report discusses the tax expenditure concept in order to facilitate understanding of the quantitative estimates. It also discusses the calculation and interpretation of the costs of tax expenditures, including key assumptions used in the analysis. The second part of the report presents estimates of the costs of tax expenditures and memorandum items in the personal and corporate income tax systems and the GST.

The report also includes a number of appendices. Descriptions of each tax expenditure as well as information on data sources and methodology used in constructing the estimates are presented in Appendix A (personal), Appendix B (corporate) and Appendix C (GST). Appendix D describes recent changes to personal income tax expenditures.

DEFINING TAX EXPENDITURES

There are several ways for the government to achieve its social and economic objectives. The government can regulate private sector activities. It can spend on programs, grants and subsidies. The government may also pursue these policy objectives through measures contained in the tax system. Methods of providing relief from the payment of taxes include tax exemptions, deductions, tax credits and deferrals. Since in many ways these measures represent an alternative form of government assistance with financial implications similar to those of direct expenditures, they are generally referred to as tax expenditures.

Tax expenditures are used to support a variety of goals ranging from promoting savings and investment, to encouraging research and development, to maintaining international competitiveness, to partially defraying the cost of charitable contributions. Many personal income tax measures, such as the age and disability credits, are based on the specific characteristics of taxpayers. Similarly, several corporate tax measures are tied to the characteristics of the business. For example, the small business deduction is only available to Canadian-controlled private corporations. Other tax expenditures, such as the pension income credit and the manufacturing and processing profits deduction, are linked to the source of income. A third possibility is tax relief linked to the use of funds, such as the Scientific Research and Experimental Development Tax Credit, which is available to businesses making qualified expenditures.

In the case of the GST, a number of measures result in a reduction in tax for particular activities or groups of taxpayers. For example, child care services and municipal transit are exempt from the GST.

What are tax expenditures?

Tax expenditures represent an alternative to direct spending for achieving government policy objectives. They are defined as deviations from a benchmark tax system. Typically, they take the form of exemptions, deductions, credits or deferrals that are available to targeted groups of individuals or businesses.

In order to provide as much information as possible, a broad definition of the benchmark tax system has been adopted.

Given the informational intent of this report, estimates are also provided for some tax measures, such as the dividend tax credit, even though they are usually considered to be part of the benchmark tax system. These tax measures are referred to as memorandum items.

Elements of the Benchmark System

In order to identify tax expenditures, it is necessary to establish a broadly based benchmark tax structure which does not contain tax preferences. Tax expenditures are then defined as deviations from this benchmark. To ensure that the estimates provide meaningful information on the cost of government operations, the benchmark tax systems used in this document are defined as consisting of the basic structural features of the current federal income tax system and the GST.

Personal and corporate income tax systems

The benchmark for the personal and corporate tax systems includes the existing tax rates and brackets, unit of taxation, time-frame of taxation, treatment of inflation for calculating income and those measures designed to reduce or eliminate double taxation.

The definition of income is crucial in determining what is a tax expenditure. Tax provisions which provide for the deduction of current costs incurred to earn income are considered to be part of the benchmark system and therefore not tax expenditures. For example, the deductibility of labour costs or economic depreciation of business assets in determining business income would not be considered a tax expenditure.

It is important to emphasize that the definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. Reasonable differences of opinion may exist as to the interpretation and categorization of tax measures. For example, unemployment insurance (UI) premiums paid by an employee could be viewed either as an expense of earning income or as a tax used to finance an income transfer to the unemployed. From the first perspective, the current system of providing employees a tax credit for contributions would not be a tax expenditure. The credit for UI premiums merely recognizes an expense of earning income, and hence, is part of the benchmark tax structure. On the other hand, one could argue that the tax credit for UI contributions represents a tax expenditure because the taxes paid by taxfilers are generally not deductible against personal income taxes. For this reason the tax treatment of UI premiums is reported as a memorandum item. Measures such as these which are subject to debate are discussed on an individual basis in Appendices A and B.

The following provides a more detailed discussion of the features of the benchmark for both the personal and corporate tax systems.

(1) Tax rates and income brackets

For the personal income tax system, the existing rate structure, including surtaxes, is taken to be part of the benchmark system. The basic personal credit is also treated as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax up to an initial level of income. However, the cost of this credit is included as a memorandum item.

With respect to the corporate income tax system, the basic federal corporate tax rate applicable to non-manufacturing corporations is 28.84 per cent including the surtax but after the provincial abatement. Provisions that reduce this tax rate for certain types of activities or corporations are regarded as tax expenditures. These include the lower tax rates for manufacturing and processing profits, and the rate for small business profits, which is available on the first $200,000 of active business income earned by most Canadian-controlled private corporations (CCPCs). The large corporations tax, levied at the existing rate, is also considered to be part of the benchmark tax system because it serves as a corporate minimum tax.

(2) Tax unit

Personal income taxes in Canada are based on individual income. Consequently, the individual is taken as the benchmark tax unit for the purposes of identifying tax expenditures in this report. This choice leads to the classification of the various provisions related to dependants, such as the married credit, as tax expenditures.

The choice of the appropriate unit for the corporate income tax benchmark system raises a number of conceptual issues. There is a wide range of possible tax units, including the establishment or activity unit within a corporation, the single legal corporate entity, and the consolidated group of related corporations. The present income tax system contains elements of all of these approaches. For example, the view that the activity unit is the appropriate unit of taxation is consistent with the "at-risk" rules, which restrict the amount of investment tax credits and business losses that may be flowed out to limited partners. The view that the single legal corporate entity is the relevant tax unit is supported by the fact that income from one part of a business can be offset by other business losses within the same corporation whereas losses by one corporation may not generally be used against the income of another corporation in the group. Other provisions in the current tax system allow corporate groups to reorganize their corporate structures without triggering any capital gains or recaptured depreciation. These rollover provisions lead to a deferral of capital gains and recaptured depreciation, which would be appropriate if the taxation unit is the consolidated group of related corporations. On balance, the view most closely related to the existing system is that of the single legal corporate entity. For this reason, the single corporation is adopted as the benchmark tax unit, together with the availability of various roll-over provisions which permit the deferral of capital gains when a corporate structure is changed.

(3) Taxation period

The benchmark taxation period for the personal income tax system in this document is the calendar year. Accordingly, any measures which provide deferrals of taxable income to a subsequent year are considered to be tax expenditures. For example, farmers are permitted to defer the receipt of income from the sale of grain through the use of special cash purchase tickets and this is listed as a tax expenditure.

The benchmark taxation period for the corporate income tax system is the fiscal year. As with the personal tax system, deferrals, such as fast write-offs of Canadian exploration and development expenditures, are considered to be tax expenditures.

A strict application of the annual taxation period would imply that measures which provide for the carry-over of losses to other years would be tax expenditures. However, the relatively cyclical nature of business and investment income suggests that it should be viewed over a number of years. Consequently, carry-overs of business and investment losses are treated as part of the benchmark tax system in this report. Estimates of the cost of these provisions are provided in the memorandum items section.

(4) Treatment of inflation

Both the personal and corporate income tax systems are based on nominal income with a number of provisions that account for the impact of inflation. Nominal income is therefore taken as the appropriate basis for the benchmark tax system. Consequently, special measures, such as the partial exclusion of capital gains from taxable income, which may serve to recognize inflation are identified as tax expenditures.

(5) Avoidance of double taxation

Conceptual difficulties arise in deciding whether certain provisions which reduce or eliminate double taxation should be considered as tax expenditures.

For example, regarding the personal and corporate income tax systems as completely separate would suggest that the dividend tax credit is a tax expenditure. However, the credit is an essential feature of the overall (i.e. both corporate and personal) income tax structure and serves to eliminate or reduce double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation and once at the personal level. For this reason, the dividend tax credit is not considered to be a tax expenditure.

Similarly, the non-taxation of inter-corporate dividends is designed to ensure that income already taxed in one corporation is not taxed again upon receipt of a dividend by another corporation. Without this exemption, double taxation would occur and the corporate income tax system would not be neutral across organizational structures. For example, consider a single corporation that currently operates as a number of divisions. Now suppose it reorganizes into a holding company with wholly owned subsidiaries instead of divisions. The profits from the subsidiaries flow to the holding company through inter-corporate dividends. If these dividends were subject to taxation at both the subsidiary and the holding company levels, double taxation would occur. Consequently, the exemption of inter-corporate dividends is not considered a tax expenditure.

Similar reasoning applies to the tax exemption on income of foreign affiliates of Canadian corporations. Canada either exempts certain dividend income paid by foreign affiliates from Canadian corporate income tax or it provides a foreign tax credit for income taxes paid in the other country. In either case, the intention is to ensure that income is not subject to double taxation (i.e. once in the country of residence of the foreign affiliate and once again in Canada when the dividends are paid out). A further discussion of this topic and the possible benchmarks that could be considered is contained in Appendix B.

Information on some of these measures that provide relief from “double taxation” is provided in the appropriate memorandum sections of this report.

The benchmark for the income tax system

The definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. A broadly based system is used as the benchmark for income taxes in this report. The essential features are:

Personal income tax

- *the existing tax rates and income brackets are taken as given;*
- *the tax unit is the individual;*
- *taxation is imposed on a calendar year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the dividend gross-up and credit.*

Corporate income tax

- *the existing general tax rate is taken as given;*
- *the tax unit is the corporation;*
- *taxation is imposed on a fiscal year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the non-taxation of inter-corporate dividends.*

Goods and Services Tax[1]

The benchmark system used to analyze the GST is a broadly based, multi-stage value-added tax collected according to the destination principle and using a tax credit mechanism to relieve the tax in the case of business inputs. The following provides a more detailed discussion of the features of the GST benchmark.

(1) Multi-stage system

The main structural elements of a multi-stage consumption tax are taken to be part of the benchmark. Under the multi-stage system, tax is applied to the sales of goods and services at all stages of the production and marketing

[1] It should be noted that this analysis deals only with the GST and not with other commodity taxes (e.g., excise taxes).

chain. At each stage, however, businesses are able to claim tax credits to recover the tax they paid on their business inputs. In this way, the tax system has the effect of applying the tax only to the value added by each business. Since the only tax that is not refunded is the tax collected on sales to final consumers, the tax rests ultimately on final consumption.

(2) Destination based

The benchmark system applies tax only to goods and services consumed in Canada. Accordingly, the tax applies to imports as well as domestically produced goods and services. Exports are not subject to the tax.

(3) Single tax rate

The benchmark system has only one tax rate. This rate corresponds to the statutory rate of 7 per cent. As a result, GST provisions that depart from this single rate are considered to be tax expenditures.

(4) Taxation period

The benchmark taxation period is the calendar year.

(5) Constitutional provisions for government sectors

Section 125 of the Constitution Act, 1867, provides that "no land or property belonging to Canada or any province shall be liable to taxation". This means that neither the federal nor the provincial governments (or their Crown agents) are liable to taxation by the other. Accordingly, Constitutional immunity from taxation is recognized as part of the benchmark system for the GST.

The benchmark also recognizes that the federal and provincial governments have taken steps to simplify the operation of the tax for transactions involving government sectors.

- The federal government decided to apply the GST to purchases by federal departments and Crown corporations in order to keep the tax as simple as possible for vendors. As a result, the GST and the benchmark system treat federal Crown corporations in the same manner as any other business entity.
- By virtue of Section 125, provincial governments and Crown agents are not liable to pay the GST on their purchases. However, the federal government and most provinces have entered into Reciprocal Tax Agreements (RTAs). These agreements specify situations in which each level of government agrees to pay the sales taxes of the other, and generally this involves applying tax to purchases made by Crown corporations. As a result, provincial Crown corporations are treated like any other business entity in the benchmark system.

Unlike provincial governments, municipalities are liable to pay the GST. Therefore, the benchmark system considers them as paying tax on their purchases. Universities, colleges, schools and hospitals are also considered to pay tax on their purchases. The GST and the benchmark generally treat

these sectors as final consumers – that is, they pay GST on their purchases, they do not claim input tax credits and they do not collect GST on their sales.

The only exception to this benchmark treatment arises from the fact that municipalities, universities, colleges, schools and hospitals engage in certain commercial activities analogous to those provided in the private sector. For example, some municipalities operate golf courses. Such commercial activities are taxable under the GST and the GST paid on associated inputs can be claimed as input tax credits.

The benchmark for the Goods and Services Tax

The essential features are:

- *basic structural features of a broadly-based, multi-stage tax system,*
- *destination approach,*
- *7-per-cent rate,*
- *calendar year basis for the taxation period, and*
- *recognition of Constitutional provisions for government sectors.*

Defining GST tax expenditures

Comparing the actual structure of the GST to the benchmark system, it is possible to identify four types of tax expenditure:

- zero-rated goods and services,
- tax-exempt goods and services,
- tax rebates, and
- tax credits.

(1) Zero-rated goods and services

Under the GST, certain categories of goods and services are considered to be taxed at a "zero" rate, rather than at the general tax rate of 7 per cent. Vendors do not charge GST on their sales of zero-rated goods and services (whether these sales are to other businesses or to final consumers). However, vendors are entitled to claim input tax credits to recover the GST they paid on inputs used to produce zero-rated products. As a result, zero-rated goods and services are tax-free.

One category of zero-rated sales is basic groceries, i.e. foods intended to be prepared and consumed at home. Other categories of zero-rated sales include prescription drugs, medical devices and most agricultural and fish products.

(2) Tax-exempt goods and services

Some types of goods and services are exempt under the GST. This means that the GST is not applied to these sales. Unlike zero-rated goods and services, however, vendors of exempt products are not entitled to claim input tax credits to recover the GST they paid on their inputs to these products.

Examples of tax-exempt goods and services include long-term residential rents, most health and dental care services, day care services, most sales by charities, most domestic financial services, municipal transit and legal aid services.

(3) Tax rebates

Certain sectors are eligible for rebates on a portion of the GST paid on inputs. For example, there are rebates for schools, universities, hospitals and municipalities. To the extent that these sectors make taxable sales, they can claim input tax credits to recover the tax they paid on inputs to these sales. Where they provide tax-exempt services, however, they are eligible to receive rebates for only a portion of the GST paid on their inputs to these services. These rebates ensure that these institutions do not bear a greater tax burden on their purchases under the GST than they would have under the manufacturers' sales tax. This treatment constitutes a tax expenditure because, under the benchmark system, these institutions are considered to be final consumers.

Other examples of tax rebates include the rebates for charities, substantially government-funded non-profit organizations and newly built housing. Also, foreign visitors to Canada are able to claim a rebate for the GST they pay on hotel accommodation and on goods they take home. Only the rebate for hotel accommodation is considered to be a tax expenditure, however, because goods taken home by foreign visitors are effectively exports which are not taxable under the benchmark system.

(4) GST credit[2]

To ensure that the GST system is fair, a GST credit is provided through the personal income tax system to single individuals and families with low and moderate incomes. The credit is paid by cheque four times a year in equal instalments. The total amount of the credit people receive depends on family size and income and is calculated annually based on information provided in the personal income tax return.

[2] It should be noted that there was a small business transitional credit which accompanied the introduction of the GST. This temporary measure provided a one-time credit of up to $1,000 to GST registrants whose taxable sales did not exceed $500,000 in their first full quarter of 1991 or in any three-month period beginning in 1990.

GST tax expenditures:

- *zero-rated goods and services,*
- *tax-exempt goods and services,*
- *tax rebates, and*
- *tax credit.*

Memorandum items for the Goods and Services Tax

As indicated earlier, some tax measures are presented as memorandum items even though they are not generally considered to be tax expenditures. For example, the refund of GST for certain employees' expenses is included as a memorandum item.

Many employees, such as commission salespeople, incur significant expenses in the course of carrying out their duties. Examples include restaurant meals and automobile expenses. Often, such expenses are not reimbursed by employers except indirectly through the salaries and commissions paid to employees. Since employees are not considered to be carrying on a commercial activity, they are not able to claim input tax credits for the GST they paid on these expenses. However, employees can receive a refund of the GST paid on those employment expenses that are deductible for income tax purposes. The refund of GST paid on employees' personal consumption expenses would constitute a tax expenditure. However, it is not possible to determine exactly what portion of these expenses should be considered personal consumption. Therefore, the refunds of GST paid on employees' expenses are reported as memorandum items. The memorandum items for the GST are discussed in more detail in Appendix C.

Calculation and Interpretation of the Estimates

The estimates indicate the cash flow impact to the government of each particular measure. Subject to the limitations described below, the estimates indicate the amount of revenue forgone in each year as a result of the tax expenditure. Accordingly, the estimates covered in this report may not be indicative of the long run or steady state revenue cost associated with each tax expenditure.

The estimates in this document reflect the amount by which federal tax revenues were reduced due to the existence of the various tax measures assuming:

(1) all measures are evaluated independently; and

(2) all other factors remain unchanged.

These methodological distinctions are important and have implications for the interpretation of the estimates. These concepts are discussed in further detail below.

Independent estimates

The estimate of the cost of each tax expenditure is undertaken separately, assuming that all other tax provisions remain unchanged. An important implication of this is that **the estimates cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined**.

As explained in more detail in the following paragraphs, this restriction arises from the fact that:

(1) the income tax rate structure is progressive; and

(2) tax measures interact with one another.

(1) Progressive income tax rates

The combined effect of claiming a number of income tax exemptions and deductions may be to move an individual to a lower tax bracket than would have applied had none of the tax measures existed. To the extent that this occurs, aggregation of the individual estimates may underrepresent the "true" cost to the federal government of maintaining all of them. For example, consider a taxpayer whose taxable income was $1,000 below the level at which he or she would move from the 17 into the 26-per-cent tax bracket. Imagine that this taxpayer arrives at this level of taxable income by using two tax deductions of $1,000 each (e.g., home relocation loan and Registered Retirement Savings Plan (RRSP) contribution). Eliminating either deduction by itself would increase taxable income by $1,000 and the taxpayer's federal tax liability by $170. Eliminating both measures simultaneously, however, would not raise the tax liability by $170 + $170, but rather by $170 + $260.

Aggregating the individual estimates for these two items would provide a misleading impression of the revenue impact of eliminating both of them. Therefore, the estimates in this document cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

While there is only one statutory tax rate for corporations, the small business deduction creates a de facto progressive tax rate schedule for some corporations. In this way, the above argument is valid for the corporate income tax system as well, although the effect is not as large as for personal income taxes.

(2) Interaction of tax measures

As noted above, the estimates are computed one at a time, assuming all other provisions remain unchanged. Given that tax provisions sometimes interact, the total cost of a group of tax expenditures calculated individually may differ from the dollar value of calculating the cost of the same group of tax expenditures concurrently. This is because adding the independently estimated costs of the tax provisions would result in double counting and so would not provide an accurate measure of the revenue which would be generated by simultaneously altering a group of measures.

For example, consider the non-taxation of veterans' allowances, which reduces the recipient's net income. Many measures, such as the medical expense credit, are calculated on the basis of net income. Thus, the reported estimate for the non-taxation of veterans' allowances represents not only the direct impact on government receipts of not taxing the allowances, but also the indirect impact of the change on the cost of other tax measures (such as the medical expense credit) which depend on net income.

Since estimates for GST tax expenditures are made using the same methodological approach as for income taxes, they too cannot be aggregated because they may interact. The following discussion of hospital rebates and zero-rating of prescription drugs illustrates the differences between independent and concurrent estimates for these two provisions.

- Eliminating hospital rebates: If hospital rebates were eliminated, hospitals would no longer be able to recover 83 per cent of the GST they pay on their purchases[3]. However, they could continue to purchase prescription drugs on a tax-free basis because these drugs are zero-rated. The estimate for hospital rebates recognizes that the rebate would not have been claimed in respect of zero-rated prescription drugs.
- Eliminating the zero-rating of prescription drugs: If prescription drugs were taxed at the GST rate of 7 per cent, then hospitals would pay the tax on their drug purchases but recover 83 per cent of the tax through the rebate system. Therefore, the estimate for the zero-rating of prescription drugs is calculated as net of the expected increase in the payment of hospital rebates.
- Eliminating the two measures concurrently has a revenue impact greater than the sum of the independent estimates because the GST would be payable on prescription drugs and hospitals would be unable to claim a rebate for these purchases.

[3] Most services provided by hospitals are exempt from the GST. This means that no tax is charged on these services but input tax credits cannot be claimed to recover the tax paid on inputs. However, hospital are able to claim a rebate of 83 per cent of the GST paid on the inputs they use to provide exempt services.

Aggregation of estimates

The estimates for individual tax expenditures cannot be added together to determine the total cost of tax expenditures. There are two reasons for this:

- *the simultaneous elimination of more than one income tax expenditure would generate different estimates because of progressive income tax rates;*
- *given the interaction of certain tax measures, the revenue impact of eliminating two or more measures simultaneously would differ from taking the independently estimated numbers published in this document and simply aggregating them.*

All other factors remain unchanged

The estimates in this report represent the amount by which federal tax revenues were reduced due to the existence of each preference assuming that all other factors remain unchanged.

In order to evaluate the extent of the revenue reduction, the approach taken here is to recalculate federal revenues assuming the measure in question has been eliminated. The difference between this recalculated figure and actual revenues provides the quantitative estimate of the cost of the tax expenditure.

The assumption that all other things remain the same means that no allowance is made for (1) behavioural responses by taxpayers, (2) consequential government policy changes, or (3) changes in tax collections due to altered levels of aggregate economic activity which might result from the elimination of a particular tax measure (further detail is provided below). Incorporating these factors would add a large subjective element to the calculations.

(1) Absence of behavioural responses

In many instances, the removal of a tax expenditure would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay, perhaps by making greater use of other tax measures. Therefore, the omission of behavioural responses in the estimating methodology generates cost estimates which may exceed the revenue increases that would have resulted if a particular provision had been eliminated.

As one example, consider the case of the deduction for RRSP contributions. Eliminating this provision would result in the amount of additional federal revenue indicated in the report only if the contributions were not directed to an alternative tax-preferred form of saving. However, the absence of the RRSP deduction might encourage individuals to place their funds instead in some other tax-favoured instrument, such as a Labour Sponsored Venture Capital Corporation. If such a response did occur, eliminating the RRSP deduction would result in a smaller increase in revenues than that indicated.

The effects of this assumption can also be illustrated for the GST by considering the housing rebate. Home-owners are eligible for a rebate of the GST they pay on the purchase of new houses. If this rebate were eliminated, the price of new houses would increase relative to the price of used houses. This, in turn, might reduce the demand for new houses while increasing the demand for used houses (which are tax exempt). Since the dynamics of the housing market are not taken into account, the revenues obtained by eliminating the housing rebate could actually be lower than the indicated estimate.

(2) Consequential government policy changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and take no account of other consequential changes in government policy. For example, if the government were to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates in this report do not provide for any such transitional relief.

Similarly, the estimates make no allowance for consequential government policy changes. For example, if lottery winnings were made taxable under the personal income tax system, an argument could be made that the cost of tickets should be deductible in the same way as other investment expenses. Furthermore, it may not be possible to track and assess small gambling winnings. This may mean that a threshold under which winnings would be non-taxable would be required. However, in calculating the cost of providing the exemption for lottery winnings, no allowance is made for such hypothetical consequential government policy changes.

(3) Impact on economic activity

The estimates do not take into account the potential impact of a particular tax provision on the overall level of economic activity and thus aggregate tax revenues. For example, although eliminating the low corporate tax rate for manufacturing and processing could generate a significant amount of revenue for the government, the amount of manufacturing activity could decline, resulting in possible job losses, a reduction in taxable income and hence a reduction in the aggregate amount of tax revenue collected. Furthermore, the derivation of the estimates does not include speculation on how the government might use the additional funds available to it and the possible impacts this could have on other tax revenues.

How to interpret the estimates

Each estimate in this report represents the amount by which federal tax revenues were reduced due to the tax expenditure assuming that all other factors remain unchanged. ***The estimates do not take into account changes in taxpayer behaviour, consequential government actions or feedbacks on aggregate tax collections through induced changes in economic activity. Accordingly, the elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the following tables.***

ESTIMATES

The majority of the personal income tax estimates in this report were computed with a personal income tax model. This model simulates changes to the personal income tax system using the statistical sample of tax returns collected by Revenue Canada for its annual publication Taxation Statistics. The model estimates the revenue impact of possible tax changes by re-computing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the moving expense deduction would result not only in a change in net income but also in all of the credits, such as the medical expense tax credit, whose values depend on net income. For those tax expenditures whose costs could not be estimated using this model alone, supplementary data were acquired from a variety of sources. Details on data sources and the methodologies used for estimating the cost of specific personal income tax measures are provided in Appendix A.

A corporate income tax model was used to measure most of the corporate tax expenditures. As with the personal income tax model, it is based on a statistical sample of tax returns collected by Revenue Canada, and is able to re-compute taxes payable on the basis of adjusted tax provisions. This re-computation of taxes takes into account the availability of unused tax credits, deductions, and losses that would be used by the corporation to minimize its tax liability. Where costs could not be estimated using this model alone, supplementary data acquired from a variety of sources were used. Details on these sources are provided in Appendix B.

The costs of the majority of the GST tax expenditures presented in this report were estimated using the input-output tables and National Accounts data prepared by Statistics Canada. In cases where estimates were not possible using these statistics alone, supplementary data from a variety of sources were used. Details on both the data sources and methodologies are provided in Appendix C.

Calculation of tax deferrals

Estimating the cost of tax deferrals presents a number of methodological difficulties since, even though the tax is not currently received, it may be collected at some point in the future. It is therefore necessary to derive estimates of the cost to the government of providing such a tax deferral while at the same time ensuring comparability with the other estimates presented here.

In this report, income tax deferrals are estimated on a "current cash-flow" basis. That is, the cost is computed as the forgone tax revenue associated with the additional net deferral in the year (deductions for the current year less the income inclusion from previous deferrals). The estimates thus computed provide a reasonably accurate picture of the ongoing costs of maintaining a particular tax provision in a mature tax system. They can be aggregated over time without double counting and are comparable to estimates of the costs associated with tax credits and deductions.

Comparison with direct expenditures

In comparing the cost of the tax expenditures in this report to direct spending estimates, it should be noted that a dollar of tax preference is often worth substantially more to the taxpayer than a dollar of direct spending. This results from the fact that, in most cases, government grants (i.e. direct spending) are taxable to the recipients. For example, consider an individual facing a marginal tax rate of 29 per cent. A deduction of $100 would be worth $29. If, instead, the government were to provide the individual with a taxable grant of $29, after-tax income would increase by only $20.59 since he/she would face an income tax liability of $8.41 ($29 x 29%).

The same conclusions do not always apply to tax expenditures provided to corporate taxpayers. Consider for example an investment tax credit to a corporation with respect to capital equipment acquired to carry out SR&ED in Canada. The cost to the government of providing a 20-per-cent tax credit would, in most circumstances, be the same as it would be if the government had provided a direct grant of 20 per cent. This is because investment tax credits are considered to be assistance and are therefore treated in the same manner as direct government grants or subsidies. The 20-per-cent tax credit, like a direct grant, is either included in income, and subject to corporate income tax, or it reduces the capital or other costs deductible by the taxpayer.

The estimates

Table 1 provides estimates of the cost to the federal government of personal income tax expenditures for 1992 and 1993 grouped according to functional categories. Table 2 provides estimates of the cost of corporate income tax expenditures for 1991 and 1992 for all corporations and by major industrial sector. The 1991 estimates in Table 2 are based on final data and may differ from the figures in last year's edition of this document, which were based on preliminary data. The grouping into functional categories is not intended as a policy justification for the specific provisions nor is it the case that all tax

measures fall neatly into one of the categories. The categories are provided solely for organizational purposes. Table 3 provides the estimates of the revenue forgone for each of the tax expenditures associated with the GST for the years 1992 and 1993. These departures from the benchmark have been grouped according to the type of tax expenditure.

All estimates are reported in millions of dollars. The letter “S” indicates that the cost is less than $2.5 million while “n.a.” signifies that data were not available. The inclusion in the report of items for which estimates are not available is warranted given that the report is designed to provide information on the type of assistance delivered through the tax system even if it is not always possible to provide a quantitative estimate. Work is continuing to replace “n.a.”s with quantitative estimates where possible. For example, the corporate income tax entry dealing with exemptions from non-resident withholding tax was an “n.a.” in last year’s report. In this year’s publication a dollar value is reported for these tax expenditures.

As previously noted, the figures and explanations for each measure are for the 1991 and 1992 taxation years in the case of corporate income tax expenditures, and for 1992 and 1993 in the case of personal income tax expenditures and the goods and services tax expenditures. Since that time, some provisions have been altered. Major changes to the tax expenditures since 1992 or 1993 are noted in the explanatory text that describes each measure (Appendices A, B, and C). For the convenience of the reader, a comprehensive list of all the provisions that have been altered since 1992 or 1993 is provided in Appendix D.

Table 1
*Personal income tax expenditures**

	1992	1993
	(millions of dollars)	
Culture and recreation		
Non-taxation of lottery and gambling winnings[1]	905	910
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S
Deduction for clergy residence	50	48
Flow-through of CCA on Canadian films	11	16
Write-off of Canadian art purchased by unincorporated business	n.a.	n.a.
Assistance for artists	n.a.	n.a.
Deduction for artists' employment expenses	n.a.	n.a.
Non-taxation of capital gains on gifts of cultural property	n.a.	n.a.
Education		
Exemption on first $500 of scholarship, fellowship and bursary income	10	7
Deduction of teachers' exchange fund contributions	S	S
Tuition fee credit	155	175
Education credit	44	43
Education and tuition fee credits transferred	165	190
Registered education savings plans	n.a.	n.a.
Employment		
Deduction of home relocation loans	4	3
Non-taxation of strike pay[2]	9	n.a.
Non-taxation of allowances to volunteer firefighters	4	4
Northern benefits deductions[3]	235	190
Overseas employment credit	27	33
Employee stock options[4]	25	57
Deferral of salary through leave of absence/sabbatical plans	n.a.	n.a.
Employee benefit plans	n.a.	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 16 to 21 for a discussion of the reasons for this.

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
Family		
Married credit	1,140	1,205
Equivalent-to-married credit[5]	585	455
Dependant credit[6]	435	12
Refundable child tax credit[7]	2,360	–
Child tax benefit[8]	n.a.	5,275
Deferral of capital gain through spousal roll-over	n.a.	n.a.
Farming and fishing		
$500,000 lifetime capital gains exemption for farm property	250	405
Net Income Stabilization Account (NISA)[9]		
Deferral of tax on government contributions	31	31
Deferral of tax on bonus and interest income	5	9
Taxable withdrawals	-19	-14
Deferral of income from destruction of livestock	S	S
Deferral of income from grain sold through cash purchase tickets[10]	-12	-15
Deferral through 10-year capital gain reserve[11]	-30	-5
Deferral of capital gain through intergenerational roll overs of family farms	n.a	n.a
Exemption from making quarterly tax instalments	n.a	n.a
Cash basis accounting	n.a	n.a
Flexibility in inventory accounting	n.a	n.a
Federal/provincial financing arrangements		
Quebec abatement	2,095	2,140
Transfers of income tax room to provinces	8,700	8,870
General business and investment		
$100,000 lifetime capital gains exemption[12]	735	1,170
Partial inclusion of capital gains[13]	745	1,185
Deduction of research and development expenditures	7	3
Deduction of limited partnership losses	220	215
Investment tax credit[14]	58	125
Deferral through five-year capital gain reserve[15]	-14	-33
Deferral through capital gains roll overs	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.
$1,000 capital gain on personal-use property	n.a.	n.a.

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
$200 capital gain on foreign exchange transactions	n.a.	n.a.
Taxation of capital gains upon realization	n.a.	n.a.
Health		
Non-taxation of employer-paid insurance premiums for private health and welfare plans	1,125	1,200
Disability credit	265	270
Medical expenses credit	225	260
Income maintenance and retirement		
Non-taxation of guaranteed income supplement and spouse's allowance payments[16]	220	225
Non-taxation of social assistance payments[16, 17]	650	705
Non-taxation of workers' compensation payments	610	610
Non-taxation of amounts received as damages in respect of personal injury or death	17	18
Non-taxation of group term insurance of up to $25,000	160	165
Non-taxation of RCMP pension/compensation for injury, disability or death	9	8
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)[18]	7	6
Non-taxation of veterans' disability pension and support for dependants[19]	140	140
Deduction of alimony and maintenance payments	200	220
Age credit	1,355	1,370
Pension income credit	295	305
Saskatchewan pension credit	S	S
Registered retirement savings plans		
Deduction for contributions	3,685	4,490
Non-taxation of investment income	2,760	3,325
Taxation of withdrawals[20]	-1,000	-930
Registered pension plans		
Deduction for contributions	4,990	5,205
Non-taxation of investment income[21]	7,865	8,610
Taxation of withdrawals	-4,580	-4,930
Deferred profit sharing plans	n.a.	n.a.
Non-taxation of up to $10,000 of death benefit	n.a.	n.a.
Non-taxation of investment income on life insurance policies[22]	–	–

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
Small business		
$500,000 lifetime capital gains exemption for small business shares	785	1,170
Deduction of allowable business investment losses	89	100
Labour-sponsored venture capital credit[23]	62	58
Deferral through ten-year capital gain reserve[24]	-7	5
Other items		
Non-taxation of War Savings Certificates/Victory Bonds	S	S
Non-taxation of capital gains on principal residences[25]		
Partial inclusion rate	2,375	2,050
Full inclusion rate	3,165	2,735
Non-taxation of income from the Office of Governor General	S	S
Assistance for prospectors and grubstakers	S	S
Charitable donations credit	865	880
Gifts to Crown credit	17	14
Political contribution credit	10	20
Non-taxation of income of Indians on reserves	n.a.	n.a.
Non-taxation of gifts and bequests	n.a.	n.a.
Memorandum items		
Non-taxation of allowances to certain public officials	5	6
Non-taxation of allowances for diplomats and and other government employees posted abroad	10	8
Child care expense deduction	315	305
Attendant care expense deduction	S	S
Moving expense deduction	59	66
Deduction of carrying charges incurred to earn income	585	540
Deduction of meals and entertainment expenses	80	110
Deduction of farm losses for part-time farmers	52	50
Farm and fishing loss carry-overs	11	11
Capital loss carry-overs	50	89
Non-capital loss carry-overs	53	73
Logging tax credit	S	S
Deduction of accelerated tax depreciation[26]	85	95
Deduction of resource-related expenditures[27]	51	78
Deduction of other employment expenses	455	490

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
Deduction of union and professional dues	440	465
Unemployment insurance		
Unemployment insurance contribution credit	1,220	1,230
Non-taxation of employer-paid premiums	2,485	2,510
Canada and Quebec pension plans		
Canada and Quebec pension plan credit	930	985
Non-taxation of employer-paid premiums	1,210	1,270
Foreign tax credit	150	185
Dividend gross-up and credit	640	635
Basic personal credit	17,265	17,130
Non-taxation of capital dividends	n.a.	n.a.

Footnotes

1 The 1992 estimate ($900 million) published in the previous edition of this report has been revised to reflect the availability of updated data from Statistics Canada concerning total lottery winnings.

2 The 1993 data were not available as of the date of publication.

3 The reduction in the tax expenditure reflects the fact that residents of communities no longer eligible for benefits or entitled to reduced benefits following the reform of northern benefits were eligible for full benefits in 1992 but only two-thirds benefits in 1993.

4 The increase in 1993 for this tax expenditure reflects the improved performance of stock markets in that year.

5 The decline from 1992 to 1993 reflects the change in the definition of spouse to include common-law spouses.

6 In 1992, taxpayers could claim a credit in respect of children and other qualified dependent relatives who were either under the age of 19 or mentally or physically infirm. Starting in 1993, with the introduction of the child tax benefit, taxpayers could claim the dependant credit for dependants over 17 years only if they were physically or mentally infirm.

7 This credit was eliminated with the introduction of the child tax benefit in 1993.

8 The child tax benefit was introduced in 1993. The estimate corresponds to amounts paid in 1993.

9 Estimates for the tax expenditures on NISA were not included in previous editions.

10 Amounts brought back into income from reserves exceeded amounts set aside in newly established reserves, giving rise to negative estimates in both years.

11 In 1992 and 1993, the amount of cash tickets outstanding declined, giving rise to negative estimates in both years.

12 80 per cent of the increase from 1992 to 1993 for this tax expenditure is attributable to an increase in gains realized on shares, reflecting in part the performance of stock markets in 1993.

13 The increase in this tax expenditure reflects the performance of stock markets in 1993.

[14] The increase from 1992 to 1993 is largely attributable to the temporary small business investment tax credit. The tax credit was provided for investments in eligible machinery and equipment made after December 2, 1992 and before 1994.

[15] Amounts brought back into income from reserves exceeded amounts set aside in newly established reserves, giving rise to negative estimates in both years.

[16] The 1992 and 1993 estimates are based on amounts reported for tax purposes. The numbers obtained are then adjusted based on data from Human Resources Development Canada, so that the amount of benefits used to compute the tax expenditure is consistent with program data.

[17] The 1992 estimate ($680 million) published in the previous edition of this report has been revised to reflect the availability of updated social assistance expenditure data from Human Resources Development Canada.

[18] The 1992 estimate ($24 million) published in the previous edition of this report has been revised to reflect the availability of additional sources of information about the average marginal tax rate for taxpayers receiving these benefits.

[19] The 1992 estimate ($170 million) published in the previous edition of this report has been revised to reflect the availability of additional sources of information about the average marginal tax rate for taxpayers receiving these benefits.

[20] The methodology for calculating tax revenues from the taxation of withdrawals has been modified to use distinct income data on RRSP annuity income and to apply different average marginal tax rates to annuity income from RRSPs and to RRSP withdrawals. As a result, the 1992 estimate differs from that in the previous edition (-$940 million). The change in RRSP withdrawals also affects RRSP investment income.

[21] The 1992 estimate ($7,690 million) published in the previous edition of this report has been revised to reflect the availability of updated data concerning assets accumulated in registered pension plans.

[22] Although this measure does provide tax relief for individuals, it is implemented through the corporate tax system. See the corporate income tax expenditure section of this report for an estimate of the value of this tax expenditure.

[23] The implementation of a ceiling by the Québec government, limiting the issuance of shares by the *Fonds de solidarité des travailleurs du Québec* to $97 million for 1993, led to a reduction of this tax expenditure. (The ceiling has since been removed.)

[24] In 1992, amounts brought back into income from reserves exceeded amounts set aside in newly established reserves, giving rise to a negative estimate.

[25] The 1992 estimate has been revised due to improvements in the methodology, in particular, to reflect improved data regarding renovations and additions to houses. This tax expenditure has been declining due to smaller increases and/or declines in the price of houses in recent years.

[26] The 1992 estimate ($100 million) published in the previous edition of this report has been revised to reflect the availability of updated data from Revenue Canada.

[27] Starting on December 2, 1992, the first $2 million of Canadian Development Expenses (CDE) for oil and gas that are renounced by a company to shareholders under a flow-through share agreement can be reclassified as Canadian Exploration Expenses (CEE) and deducted accordingly, i.e. 100 per cent in the first year rather than 30 per cent per year declining balance.

Table 2
*Corporate income tax expenditures**
All corporations

	1991**	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses[1]	2,087	1,934
Low tax rate for manufacturing and processing[2]	349	368
Low tax rate for credit unions and co-operatives	54	60
Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations	n.a.	n.a.
Exemption from tax for international banking centres	n.a.	n.a.
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit[3]	578	597
Atlantic Canada Investment Tax Credit	23	34
Special Investment Tax Credit	10	7
Cape Breton Investment Tax Credit	4	3
Exploration Tax Credit[4]	S	–
Small Business Investment Tax Credit	S	5
ITCs claimed in current year but earned in prior years	195	211
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	412	436
Resource allowance[5]		
Non-deductibility of Crown royalties	-317	-358
Resource allowance	232	272
Earned depletion[6]	39	39
Deductibility of charitable donations	74	82
Gifts to the Crown	S	S
Non-deductibility of advertising expenses in foreign media	n.a.	n.a.
Non-taxation of provincial assistance for venture investments in small business	n.a.	n.a.

* The elimination of a tax expenditures would not necessarily yield the full tax revenues shown in the table. See pages 16 to 21 for a discussion of the reasons for this.

** The 1991 figures are based on final data and may differ from the figures in last year's edition of this document which were based on preliminary data.

All corporations (cont'd)

	1991	1992
	(millions of dollars)	
Deferrals[7]		
Fast write-off for capital equipment used for scientific research and experimental development	72	53
Allowable business investment losses	39	45
Holdback on progress payments to contractors	-15	6
Deductibility of carrying charges on land[8]	5	–
Available for use[9]	–	n.a.
Capital gains taxation on realization basis	n.a.	n.a.
Expensing of advertising costs	n.a.	n.a.
Cash basis accounting	n.a.	n.a.
Flexibility in inventory accounting	n.a.	n.a.
Deferral of income		
On grain sales	n.a.	n.a.
On destruction of livestock	n.a.	n.a.
Deferral of tax from use of billed-basis accounting by professionals	n.a.	n.a.
International		
Non-taxation of life insurance companies' world income	85	60
Exemptions from non-resident withholding tax[10]		
Copyright royalties	78	80
Royalties for the use of, or right to use, other property	32	39
Interest on deposits	454	397
Interest on long-term corporate debt	412	450
Dividends	77	80
Management fees	9	10
Exemption of foreign shipping and aircraft companies from Canadian income tax	n.a.	n.a.
Other tax expenditures		
Transfer of income tax room to provinces in respect of shared programs[11]	420	353
Interest credited to life insurance policies	55	60
Non-taxation of registered charities	n.a.	n.a.
Income tax exemption for provincial and municipal corporations	n.a.	n.a.
Non-taxation of certain federal Crown corporations	n.a.	n.a.
Excise Tax Transportation rebate[12]	–	45

All corporations (cont'd)

	1991	1992
	(millions of dollars)	
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	772	699
Fast write-off for Canadian development expenses and Canadian exploration expenses[13]	575	680
Deductibility of Crown royalties for the Syncrude project (Remission Order)	18	18
Deductibility of royalties paid to Indian bands	n.a.	n.a.
Refundable Part I tax on investment income of private corporations	877	808
Refundable capital gains for special investment corporations[14]	141	41
Loss carry-overs		
Non-capital losses[15]	1,660	1,074
Net capital losses	n.a.	n.a.
Farm losses and restricted farm losses	n.a.	n.a.
Meals and entertainment expenses	392	434
Large corporations tax		
Threshold	500	500
Exempt corporations	n.a.	n.a.
Patronage dividend deduction by credit unions and co-operatives	179	129
Logging tax credit	3	7
Non-resident-owned investment corporation refund[16]	49	16
Investment corporation deduction	S	S
Deferral of capital gains income through various rollover provisions	n.a.	n.a.
Excess deduction for intangible assets	n.a.	n.a.
Tax exemption on income of foreign affiliates of Canadian corporations	n.a.	n.a.

Agriculture, Forestry, Fishing

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	93	105
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	4	4
Atlantic Canada Investment Tax Credit	S	5
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	3
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	3	3
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	6	5
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	S	S
Refundable Part I tax on investment income of private corporations	12	8
Loss carry-overs		
Non-capital losses	7	5
Meals and entertainment expenses	S	S
Logging tax credit	S	S

Manufacturing

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	221	225
Low tax rate for manufacturing and processing	298	325
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	293	284
Atlantic Canada Investment Tax Credit	13	13
Special Investment Tax Credit	10	5
Cape Breton Investment Tax Credit	4	S
ITCs claimed in current year but earned in prior years	115	112
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	32	25
Deductibility of charitable donations	16	18
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	31	20
Allowable business investment losses	5	21
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	96	81
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-18	-124
Refundable Part I tax on investment income of private corporations	19	15
Loss carry-overs		
Non-capital losses	588	267
Meals and entertainment expenses	92	92
Logging tax credit	S	6

Construction

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	289	232
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	3	3
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	11	18
Deductibility of charitable donations	3	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	6	3
Holdback on progress payments to contractors	-15	6
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	26	22
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	15	6
Refundable Part I tax on investment income of private corporations	34	27
Loss carry-overs		
Non-capital losses	102	83
Meals and entertainment expenses	26	42

Transportation and storage

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	79	64
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	3
Atlantic Canada Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	7	S
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	12	10
Excise Tax Transportation rebate	–	45
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	24	35
Refundable Part I tax on investment income of private corporations	8	5
Loss carry-overs		
Non-capital losses	46	39
Meals and entertainment expenses	17	17
Logging tax credit	S	S

Communications

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	8	4
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	53	59
Atlantic Canada Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	30	35
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	S
Deductibility of charitable donations	3	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	21	18
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	25	66
Refundable Part I tax on investment income of private corporations	S	S
Loss carry-overs		
Non-capital losses	7	5
Meals and entertainment expenses	12	12

Public utilities

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	5	5
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	10
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	6	5
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	59	44
Refundable Part I tax on investment income of private corporations	S	4
Loss carry-overs		
Non-capital losses	9	4
Meals and entertainment expenses	S	3

Wholesale trade

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	223	240
Low tax rate for manufacturing and processing	25	10
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	52	56
Atlantic Canada Investment Tax Credit	S	3
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	20	10
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	12	6
Deductibility of charitable donations	7	5
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	6	5
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	42	35
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	38	96
Refundable Part I tax on investment income of private corporations	17	17
Loss carry-overs		
Non-capital losses	127	80
Meals and entertainment expenses	58	75
Logging tax credit	S	S

Retail trade

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	345	257
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	3	11
Deductibility of charitable donations	3	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	26	22
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	14	S
Refundable Part I tax on investment income of private corporations	33	32
Loss carry-overs		
Non-capital losses	108	94
Meals and entertainment expenses	27	21

Finance

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	272	255
Low tax rate for manufacturing and processing	6	S
Low tax rate for credit unions and co-operatives	54	60
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	32	35
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	11	5
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	324	309
Deductibility of charitable donations	29	34
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	4	4
Allowable business investment losses	11	12
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	124	104
Interest credited to life insurance policies	55	60
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	478	405
Refundable Part I tax on investment income of private corporations	691	653
Refundable capital gains for special investment corporations	141	41
Loss carry-overs		
Non-capital losses	324	186
Meals and entertainment expenses	65	79
Non-resident-owned investment corporation refund	49	16
Investment corporation deduction	S	S

Services

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	511	513
Low tax rate for manufacturing and processing	6	8
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	96	115
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
Cape Breton Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	6	11
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	11	17
Deductibility of charitable donations	5	6
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	23	18
Allowable business investment losses	14	6
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	41	35
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	194	238
Refundable Part I tax on investment income of private corporations	51	38
Loss carry-overs		
Non-capital losses	138	121
Meals and entertainment expenses	57	59
Non-resident-owned investment corporation refund	S	S
Investment corporation deduction	S	S

Oil and gas

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	20	12
Low tax rate for manufacturing and processing	10	16
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	13	14
Atlantic Canada Investment Tax Credit	3	11
Exploration Tax Credit	S	–
ITCs claimed in current year but earned in prior years	5	28
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	5	27
Resource allowance		
Non-deductibility of Crown royalties	-307	-342
Resource allowance	194	241
Earned depletion	33	37
Deductibility of charitable donations	5	7
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	6	4
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	16	13
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-39	-60
Fast write-off for Canadian development expenses and Canadian exploration expenses	493	599
Deductibility of Crown royalties for the Syncrude project (Remission Order)	18	18
Refundable Part I tax on investment income of private corporations	5	3
Loss carry-overs		
Non-capital losses	107	44
Meals and entertainment expenses	5	6

Mining

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	8	5
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	12	6
Atlantic Canada Investment Tax Credit	S	S
Cape Breton Investment Tax Credit	S	3
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	3
Resource allowance		
Non-deductibility of Crown royalties	-10	-16
Resource allowance	38	31
Earned depletion	6	S
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	4	3
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-14	-10
Fast write-off for Canadian development expenses and Canadian exploration expenses	82	81
Refundable Part I tax on investment income of private corporations	4	S
Loss carry-overs		
Non-capital losses	96	144
Meals and entertainment expenses	9	6

Footnotes

[1] The decrease in revenue cost for the low tax rate on small businesses was due to the decline in taxable income between 1991 and 1992.

[2] Despite a decline in taxable income between 1991 and 1992, the revenue cost for the preferential tax rate on M&P profits increased due to a one-percentage-point increase in the M&P deduction during 1991.

[3] The numbers reported do not reflect the fact that SR&ED tax credits reduce the SR&ED expenditure pool in the taxation year after the credits are either used to reduce taxes otherwise payable or refunded. This generally increases taxable income in that year because the amount deductible is reduced. It is estimated that the annual revenue from the taxback is about $100 million.

[4] The measure was no longer effective in 1992.

[5] In this publication, tax expenditures are reported separately for the deductibility of Crown royalties and Resource allowance. Also, the tax expenditure items for deductibility of provincial royalties for the Syncrude project (Remission Order) and royalties paid to Indian bands have been moved to the "Memorandum item" section. Changes in tax expenditure reporting reflect changes in the underlying assumptions and methods. See explanation in each corresponding item in Appendix B.

[6] Due to the elimination of the earned depletion allowance, there have been no additions to this expenditure pool since 1989.

[7] Fast write-off for Canadian development expenses and Canadian exploration expenses, which used to be under Deferrals, has been moved to the "Memorandum items" section as a combined item. See explanation in Appendix B.

[8] The measure was no longer effective in 1992.

[9] The measure was not effective until 1992.

[10] These estimates are based on the benchmark assumption that no behavioural response would occur after the hypothetical removal of existing withholding tax exemptions. This assumption is particularly difficult to sustain for this type of tax, as indicated in the text, which means that the amounts shown in the table should not be regarded as estimates of the revenue gain that would be realized from the hypothetical removal of the listed withholding tax exemptions.

[11] The decrease in revenue cost for the transfer of income tax room to provinces in respect of shared programs was due to the decline in taxable income between 1991 and 1992.

[12] The Excise Tax Transportation rebate was introduced in December 1991.

[13] See also Natural Resources Canada's tax expenditure estimates for CDE & CEE in Appendix B, under "Memorandum Items" section.

[14] The decrease between 1991 and 1992 is mainly due to a decrease in dividends distributed to shareholders.

[15] A decline in taxable income between 1991 and 1992 resulted in a decrease in non-capital losses carried over between these two years.

[16] The decrease between 1991 and 1992 is mainly due to a decrease in dividends distributed to shareholders.

Table 3
*GST tax expenditures**

	1992[1]	1993
	(millions of dollars)	
Zero-rated goods and services		
Basic groceries	2,455	2,555
Prescription drugs	160	185
Medical devices	150	165
Agricultural and fish products and purchases	S	S
Certain zero-rated purchases made by exporters	S	S
Non-taxable importations	n.a.	n.a.
Tax exempt goods and services		
Long-term residential rent	1,020	1,065
Health care services	315	335
Education services (tuition)	330	345
Child care and personal services	105	110
Legal aid services	25	25
Ferry, road and bridge tolls	10	10
Municipal transit	60	65
Exemption for small businesses	95	100
Quick method accounting	105	115
Water and basic garbage collection services	100	115
Domestic financial services	n.a.	n.a.
Exempt supplies made by non-profit organizations	n.a.	n.a.
Tax rebates		
Rebates for municipalities	495	505
Rebates for hospitals	280	275
Rebates for schools	290	305
Rebates for universities	115	120
Rebates for colleges	50	50
Rebates for charities	115	120
Rebates for non-profit organizations	70	75
Housing rebate[2]	435	415
Rebate for foreign visitors on accommodation	15	15
Special credit for certified institutions	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 16 to 21 for a discussion of the reasons for this.

GST tax expenditures (cont'd)

	1992[1]	1993
	(millions of dollars)	
Tax credit		
The GST credit	2,490	2,645
Memorandum Items		
Meals and entertainment expenses	190	205
Rebate to employees and partners	55	60
Sales of personal-use real property	n.a.	n.a.

Footnotes

[1] The 1992 estimates might differ from the 1992 estimates shown in the previous Tax Expenditures released in December 1994 because of revisions to Statistics Canada's data.

[2] The decline in the cost in 1993 can be explained by the decline in the value of residential housing in the National Accounts.

APPENDIX A
DESCRIPTION OF PERSONAL INCOME TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a simplified reference. It should be noted that the explanations refer to the 1992 and 1993 taxation years. Since that time, some provisions have been altered.

A number of measures which primarily affect corporations, but also have an impact on non-incorporated businesses, are treated under the corporate income tax measures section.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the personal income tax simulation model described in the main text.

Culture and Recreation

Non-taxation of lottery and gambling winnings

Lottery and gambling winnings are excluded from income for tax purposes.

The estimate for the non-taxation of winnings in government lotteries is based on information provided by Statistics Canada. Values for the non-taxation of winnings from horse-racing are estimated using data provided by Agriculture Canada.

The values do not include amounts from other types of gambling, such as bingo, where no accurate data are available. As a result, the cost of the tax expenditure may be underestimated. On the other hand, no adjustments are made for the possible deductibility of lottery ticket purchases which might accompany the taxation of lottery winnings.

Deduction for certain contributions by individuals who have taken vows of perpetual poverty

Where a person has taken a vow of perpetual poverty as a member of a religious order, that person may deduct donations to the religious order up to his/her total employment and pension income (but not investment or other income) in lieu of the charitable donations credit.

Deduction for clergy residence

A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct housing costs from income for tax purposes. Where a member of the clergy is supplied living accommodation by his/her employer or receives housing allowances, an offsetting deduction may be claimed to the extent that this benefit is included in income. The estimate for this item is based on the number of clergy in Canada and Statistics Canada expenditure data on rent.

Flow through of CCA on Canadian films

The capital cost allowance (CCA) rate generally available on films is 30 per cent subject to the half-year rule. On "certified Canadian films", the half-year rule does not apply. The CCA may be flowed through to investors and deducted against their other sources of income. An additional allowance of up to the remaining undepreciated capital cost of the film is deductible against an investor's income from certified Canadian films. Investments in television commercials may be depreciated at a rate of 100 per cent.

Losses arising from CCA claimed at the partnership level and flowed through as limited partnership losses are included in the "Deduction of limited partnership losses" tax expenditure. It is estimated that 15 per cent of limited partnership losses relate to CCA on Canadian films.

(The 1995 budget proposed that the flow-through of the CCA be replaced with a refundable tax credit.)

Write-off of Canadian art purchased by unincorporated businesses

Canadian art acquired by businesses for display in an office may be depreciated on a 20-per-cent declining balance basis even though Canadian art may depreciate at a much slower rate, and may even appreciate.

No data are available.

Assistance for artists

Artists may deduct the costs of creating a work of art in the year the costs are incurred rather than in the year the work of art is sold.

Artists may also elect to value a charitable gift from their inventories at any amount up to its fair market value. This value is then used to determine the artist's income and the amount that qualifies for the charitable donations credit. The restriction that donations eligible for the charitable donations tax credit cannot exceed 20 per cent of income does not apply.

No data are available.

Deduction for artists and musicians

Employed musicians are able to claim the cost of maintenance, rental, insurance and capital cost allowance on musical instruments against employment income earned as a musician.

Since 1991, employed artists have also been entitled to deduct expenses related to their artistic endeavours up to the lesser of $1,000 or 20 per cent of their income derived from employment in the arts.

No data are available.

Non-taxation of capital gains on gifts of cultural property

Certain objects certified as being of cultural importance to Canada are exempt from capital gains tax if donated to a designated museum or art gallery.

Such donations amounted to $51 million in 1992 and $105 million in 1993. However, there is no information on the portion of the value which represents capital gains.

Education

Exemption on first $500 of scholarship, fellowship and bursary income

The first $500 of scholarship, fellowship and bursary income is exempt from income tax.

The values reported in the table are understated since no data are available on individuals receiving scholarship, fellowship or bursary income of less than $500.

Deduction of teachers' exchange fund contributions

Teachers may deduct up to $250 per year in contributions to a fund established by the Canadian Education Association for the benefit of teachers from Commonwealth countries visiting Canada under a teachers' exchange agreement.

Tuition fee credit

A 17-per-cent tax credit is available for tuition fees paid by students to a prescribed educational institution. The credit is not available if the total tuition fees paid to institutions are $100 or less.

Education credit

Students who are enrolled at prescribed educational institutions on a full-time basis are entitled to claim a tax credit of 17 per cent of $80 for every month of full-time attendance.

Education and tuition credits transferred

The unused portion of the education and the tuition fee amounts may be transferred to a supporting spouse, parent or grandparent. The maximum transfer for the two credits combined is 17 per cent of $4,000.

Registered education savings plans

A taxpayer may contribute to a registered education savings plan on behalf of a designated beneficiary (usually the taxpayer's child). The contribution cannot exceed $1,500 per beneficiary, with an overall limit of $31,500.

The investment return on these funds is not taxable until it is withdrawn by the beneficiary for educational purposes, and is generally taxable in the hands of the beneficiary rather than the contributor.

No data are available.

Employment

Deduction of home relocation loans

For up to five years, an offsetting deduction from taxable income is provided for the benefit received by an employee in respect of a home relocation loan. The amount of the deduction is the lesser of the amount included in income as a taxable benefit and the amount of the benefit that would arise in respect of an interest-free loan of $25,000.

Non-taxation of strike pay

Strike pay is non-taxable.

The estimates are based on data provided by Statistics Canada's annual report on Corporations and Labour Unions Return Act Part II (CALURA, Catalogue 71-202).

Non-taxation of allowances for volunteer firefighters

Volunteer firefighters may receive up to $500 per year in non-taxable allowances.

The estimates are based on census data.

Northern residents deductions

Individuals living in prescribed areas in Canada for a specified period may claim the northern residents deductions. The benefits consist of a residency deduction of up to $15 a day, a deduction for two employer-provided vacation trips per year, and unlimited employer-provided medical travel. Residents of the Northern Zone are eligible for full benefits, while residents of the Intermediate Zone are eligible for 50 per cent of the benefits.

The current definition of prescribed areas came into force in 1991. However, the implementation of the current system was gradual. Certain communities, which had qualified under the pre-1991 regime but which are no longer eligible under the current system continued to receive full benefits until 1992, and received two-thirds benefits in 1993. Other communities, which had qualified under the pre-1991 regime but are eligible for 50 per cent of the full deductions under the current system continued to receive full benefits until 1992, and received two-thirds benefits in 1993.

Overseas employment credit

A tax credit is available to Canadian employees working abroad for more than six months in connection with certain resource, construction, installation, agricultural or engineering projects. The credit is equal to the tax otherwise payable on 80 per cent of the employee's net overseas employment income taxable in Canada, to a maximum credit of $80,000.

Employee stock options

Employees are not generally required to report any employment benefit on employer-provided stock options until the option is exercised. At that time, a deduction of one-quarter of the difference between the option price and the fair market value is provided. This provides both a deferral of tax and a preferential rate.

In addition to this general stock option tax treatment, employees of Canadian-controlled private corporations (CCPCs) receive a further deferral advantage since they need not include the calculated benefit in their income until they dispose of the shares. At the time of disposition, a deduction is provided for one-quarter of the difference between the option price and the fair market value at the time the employee exercised the option.

The estimates are computed by assuming the elimination of the deduction, and therefore do not capture the deferral benefit.

Deferral of salary through leave of absence/sabbatical plans

Employees may be entitled to defer salaries through a leave of absence/sabbatical plan. These amounts are not subject to tax until received.

No data are available.

Employee benefit plans

In certain circumstances, employers may make contributions to an "employee benefit plan" on behalf of their employees. The employee is not required to include in income the contributions to the plan or the investment income earned within the plan until amounts are received. Employers may not deduct these contributions to the plan until these contributions are actually distributed to the employees.

No data are available.

Non-taxation of certain non-monetary employment benefits

Certain fringe benefits provided to employees by their employers are not taxable. Examples include subsidized meals in staff cafeterias, subsidized recreational facilities and special clothing.

No data are available.

Family

Married credit

A married taxpayer supporting a spouse is entitled to a tax credit of 17 per cent of $5,380. This credit is reduced by 17 per cent of the amount by which the dependent spouse's income exceeded $538.

Effective with the 1993 taxation year, the definition of spouse for tax purposes has been expanded to include common-law spouses, provided that the couple have lived together at least one year or have a common child.

Equivalent-to-married credit

An "equivalent-to-married" tax credit may be claimed in respect of a dependent child under 18 or a parent or grandparent by taxpayers without a spouse. The amount of the credit and the limitation on the dependant's income are the same as for the married credit.

Dependant credit

In 1992, taxpayers could claim a credit in respect of children and other qualified dependent relatives who were either under the age of 19 or mentally or physically infirm. The tax credit was $417 for each of the first two dependants under the age of 19, $834 for each additional dependant under the age of 19 and $1,583 for each infirm dependant. These amounts were reduced by 17 per cent of the amount of the dependant's net income in excess of $2,690. This credit for dependants under the age of 19 was eliminated with the introduction of the child tax benefit in 1993.

Starting in 1993, taxpayers could claim the dependant credit for dependent relations over 17 years who were physically or mentally infirm. A credit of $1,583 applies to any qualified dependant whose income is below $2,690. The credit is exhausted when the dependant earns an income of $4,273 or more.

Refundable child tax credit

In 1992, individuals receiving family allowances were entitled to an income-tested refundable child tax credit. The basic amount was $601 per child. A supplement of $213 was available for each child under the age of seven. This supplement was reduced by 25 per cent of all child care expenses deducted. The combined credit was reduced by 5 per cent of the amount of the parents' net income in excess of $25,921.

This credit for dependants under the age of 18 was eliminated with the introduction of the child tax benefit in 1993.

Child Tax Benefit

The child tax benefit was introduced in 1993, replacing the family allowance, the dependant credit for children under 18 years of age and the refundable child tax credit. The child tax benefit payments are made monthly and are non-taxable.

The child tax benefit provides a basic credit of $1,020 per child annually, plus $75 for the third and each subsequent child. It also includes a supplement of $213 for each child under age 7, the total of which is reduced by 25 per cent of the child care expenses claimed. The total benefit is reduced by 5 per cent (2.5 per cent for one-child families) of family net income over $25,921.

The child tax benefit also includes an earned income supplement for low-income working families equal to 8 per cent of the family earned income in excess of $3,750 (not exceeding a maximum supplement of $500). The supplement is reduced by 10 per cent of the family net income in excess of $20,921.

Deferral of capital gains through transfer to spouse

Individuals may transfer capital property to their spouses or spousal trusts at the adjusted cost base of the property rather than the fair market value. This provides a deferral of the capital gain until the subsequent disposition of the property or until the transferee spouse dies.

Property transferred to other family members or to unrelated individuals (or to trusts of which they are beneficiaries) is treated differently. The transferor is generally deemed to have disposed of the property at the time of transfer and must include any resulting capital gain in income at that time.

In the case of property transferred to a trust, the tax treatment again differs depending on whether or not the beneficiary of the trust is a spouse. The treatment of spousal trusts is described above. For non-spousal trusts, capital gains are subject to tax not only when property is transferred to the beneficiary, but also periodically while it remains in the trust. These periodic deemed dispositions generally occur every 21 years. However, the period can be extended until the rights of beneficiaries expire, provided those beneficiaries are the children or other qualifying beneficiaries of the individual who created the trust.

(The 1995 budget proposed to eliminate the application of the 21-year rule by January 1, 1999.)

No data are available.

Farming and Fishing

$500,000 lifetime capital gains exemption for farm property

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified farm property. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption and the $500,000 lifetime capital gain exemption on small business shares have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Net Income Stabilization Accounts (NISA)

Farmers may deposit up to 22 per cent of a given year's eligible net sales, up to a limit, to their Net Income Stabilization Account (NISA). No tax deduction is given in respect of these deposits. The federal and provincial governments each provide equal matching contributions of up to a combined total of 2 per cent of eligible net sales. They also pay a 3-per-cent interest bonus annually on the farmer's deposits which remain in the account. Governments' contributions and interest accrued in the account are not taxable until withdrawn. All withdrawals from the NISA are taxable except for the contributor's original deposits, which were made with after-tax dollars. Withdrawals from the NISA are triggered if current year gross margin (net sales less eligible expenses) is less than the five-year average gross margin, or if net income is below $10,000 (or $20,000 of family net income if the family held only one account).

The federal tax expenditure is a function of two components: the deferral of tax on the investment income accrued in the account, and on government contributions to the account; and the income inclusion of these amounts when withdrawn from the account. The former has the effect of increasing tax expenditures, while the latter has the opposite effect. The estimates provided in the table are made on a current cash-flow basis. That is, they measure the impact on the deficit of the tax measure in each of the years under consideration.

Deferral of income from destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

The estimates are based on data provided by Agriculture Canada.

Deferral of income on grain sold through cash purchase tickets

Under the cash purchase ticket program of the Canadian Wheat Board, farmers may make deliveries of grain before the year end and receive payment in the form of a ticket that may be cashed in subsequent years. The payment is included in income only when the ticket is cashed.

The estimates are based on data provided by the Canadian Wheat Board.

Deferral through 10-year capital gain reserve

If proceeds from a sale of a farm property to a child, grandchild or great-grandchild are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year, creating a maximum 10-year reserve period. For most other assets, the maximum reserve period is five years.

Deferral of capital gain through intergenerational roll-overs of family farms

Sales or gifts of assets to children, grandchildren or great-grandchildren typically give rise to taxable capital gains to the extent that the fair market value exceeds the adjusted cost base of the property. However, capital gains on intergenerational transfers of farm property are deferred until the property is disposed of outside the immediate family.

No data are available.

Exemption from making quarterly tax instalments

Taxpayers earning business income must normally pay quarterly income tax instalments. However, individuals engaged in farming and fishing pay two-thirds of their estimated tax payable at the end of the taxation year and the remainder on or before April 30 of the following year.

No data are available.

Cash basis accounting

Individuals engaged in farming and fishing may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income inclusion and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues, and expenses are deductible for the period to which they relate.

No data are available.

Flexibility in inventory accounting

Farmers using the cash basis method of accounting are allowed to depart from it with regard to their inventory. Under cash accounting, net additions to inventory are treated as a cost which is deducted in computing income. When inventory is increasing from year to year, such costs could create a loss for tax purposes. However, a discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farmers to avoid creating losses which would be subject to the time limitation if carried forward. The value of the tax expenditure is thus the amount of tax relief associated with the losses that would otherwise have been subject to the time limitations.

No data are available.

Federal/Provincial Financing Arrangements

Quebec abatement

Under the contracting-out arrangements which were offered to provinces in the mid-1960s for certain federal transfer programs, provinces could elect to receive part of the federal contribution in the form of a tax point transfer. Quebec was the only province to elect this arrangement at the time and this has resulted in a 16.5 percentage-point abatement of federal tax for Quebec residents.

Transfers of income tax room to provinces

In 1967, the federal government transferred tax points to all provinces in place of certain direct cash transfers under the cost-shared program for post-secondary education. As a result, the personal income tax abatement was increased by 4 percentage points. In 1977, an additional 9.5 percentage points of individual income tax were provided to the provinces in respect of post-secondary, hospital insurance, and medicare programs.

General Business and Investment

$100,000 lifetime capital gains exemption

The first $100,000 of lifetime capital gains realized by individuals was non-taxable. The exemption was available only to the extent that the gains exceeded cumulative net investment losses incurred after 1987. The costs of tax expenditures associated with capital gains realized on exempt qualified farm property and exempt qualified small business shares are listed separately, even though some of these gains would qualify for the $100,000 lifetime capital gains exemption.

The 1992 budget eliminated the exemption for real estate gains accruing after February 1992 on property not used in an active business.

(The 1994 budget eliminated the $100,000 lifetime capital gains exemption for 1995 and subsequent tax years.)

Partial inclusion of capital gains

Only three-quarters of net realized capital gains are included in income.

Deduction of scientific research and experimental development expenditures

All scientific research and experimental development (SR&ED) expenditures may be deducted immediately, despite the fact that some of these expenditures may be capital in nature.

The estimates are calculated on the basis that 10 per cent of SR&ED expenditures are of a capital nature. In the absence of this SR&ED provision, these amounts would have been depreciated over several years (subject to CCA rules) rather than immediately. The proportion of SR&ED that is of a capital nature is estimated from Revenue Canada data. The estimate is based on the fact that SR&ED expenditures of a capital nature are deductible in the year the expenditures are made rather than subject to CCA rules. However, it does not take into consideration the deduction that would otherwise be available in future years. Accordingly, it overestimates the true cost of the measure to the extent that CCA would otherwise have been deducted over the course of a number of years. A more detailed explanation is provided in Appendix B.

Deduction of limited partnership losses

A limited partner is able to deduct losses against other income up to the amount of investment at risk whereas a shareholder is normally not permitted to deduct corporate losses against personal income. Unused losses may be carried back three years or forward seven years and are deductible up to the amount of investment at risk.

Limited partnership losses arise from a range of investments, from real estate investments to certified film productions. It is estimated that 15 per cent of this tax expenditure is attributable to CCA claimed on Canadian films.

Investment tax credit

A tax credit is available for investments in scientific research and experimental development, exploration activities and certain regions. The tax credits range from 15 per cent to 45 per cent. The estimates treat the full investment tax credit as a tax expenditure even though tax credits reduce the capital cost of assets for CCA purposes and the adjusted cost base for capital gains purposes. A more detailed explanation is provided in Appendix B.

Deferral through five-year reserve

If proceeds from a sale of capital property are not all receivable in the year of the sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds are received. A minimum of 20 per cent of the gain must be brought into income each year, creating a maximum five-year reserve period.

Deferral through capital gains roll-overs

In certain circumstances, taxpayers may defer the reporting of capital gains for tax purposes. General business roll-over provisions may be categorized into three groups:

Involuntary dispositions

Capital gains resulting from an involuntary disposition (e.g., insurance proceeds received for an asset destroyed in a fire) may be deferred if the funds are reinvested in a replacement asset within a specified period. The capital gain is taxable upon disposition of the replacement property.

Voluntary dispositions

Capital gains resulting from the voluntary disposition of land and buildings by businesses may be deferred if replacement properties are purchased soon thereafter (for example, a business changing location). The roll-over is generally not available for properties used to generate rental income.

Transfers to a corporation for consideration including shares

Individuals may transfer an asset to a corporation controlled by them or their spouses and elect to roll over any resulting capital gain or recaptured depreciation into the corporation instead of paying tax in the year of sale.

No data are available.

Deferral through billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

$1,000 capital gains exemption on personal-use property

Personal-use property is held primarily for the use and enjoyment of the owner rather than as an investment.

In calculating the capital gain on personal use property, if the proceeds of disposition are less than $1,000, no capital gain needs to be reported. If the proceeds exceed this amount, the adjusted cost base (ACB) will be deemed to be a minimum of $1,000, thus reducing the capital gain in situations where the true ACB is less than $1,000.

No data are available.

$200 capital gains exemption on foreign exchange transactions

The first $200 of net capital gains on foreign exchange transactions is exempt from tax.

No data are available.

Taxation of capital gains upon realization

Capital gains are taxed upon the disposition of property and not when they accrue. This provides a tax deferral.

No data are available.

Health

Non-taxation of employer-paid insurance benefits for group private health and dental plans

Employer-paid benefits for private health and dental plans are not taxable.

The estimates are based on data from Statistics Canada and from an annual survey "Health Insurance Benefits in Canada", conducted by the Canadian Life and Health Insurance Association.

Disability credit

Canadians who are markedly restricted in the basic activities of daily living are entitled to a tax credit. In 1992 and 1993, the credits were 17 per cent of $4,233. Any unused amount of the credit may be transferred to a supporting person.

Medical expenses credit

In 1992 and 1993, taxpayers were entitled to a 17-per-cent credit for eligible medical expenses incurred by the taxpayer, the taxpayer's spouse or by dependants. The credit was available in respect of expenses which exceeded the lesser of 3 per cent of net income or $1,615.

Income maintenance and retirement

The non-taxation of income-tested programs such as the guaranteed income supplement and provincial social assistance presents conceptual difficulties. The problems arise because, in many respects, these programs operate like

an income tax in that eligibility for benefits is phased out after a certain income level. In this regard, excluding such benefits from income tax might not be considered a tax expenditure since they are subject to their own "tax". On the other hand, a broadly based benchmark tax system would include such amounts in income. Given the comprehensive approach taken in this document, these items are considered to be tax expenditures.

Non-taxation of guaranteed income supplement and spouse's allowance benefits

The guaranteed income supplement (GIS) is an income-tested benefit payable to old age security (OAS) pensioners. Spouses of OAS recipients (or widows/widowers) aged between 60 and 64 may be eligible for the spouse's allowance (SPA). Benefits under both the guaranteed income supplement and spouses' allowance programs are non-taxable. Although GIS and SPA benefits must be included in income, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on data from the Human Resources Development Canada publication, *Statistics Related to Income Security Programs* and the personal income tax simulation model.

Non-taxation of social assistance benefits

Social assistance payments received by low-income Canadians must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such assistance payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on the personal income tax simulation model and data provided by Human Resources Development Canada.

Non-taxation of workers' compensation benefits

Workers' compensation payments must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

Non-taxation of certain amounts received as damages in respect of personal injury or death

Amounts received in respect of damages for personal injury or death, and awards paid pursuant to the authority of criminal-injury compensation laws are not taxable. In addition, investment income earned in personal injury awards is excluded from income until the end of the year in which the person reaches the age of 21.

The values reported in the tables understate the tax expenditure since they are based on awards paid by provinces' Criminal Injuries Compensation Boards only. No data were available for compensation awards paid by other sources, or regarding the investment income earned on awards by individuals under 22.

Non-taxation of employer-paid premiums for group term life insurance of up to $25,000

Employer-paid premiums for group term life insurance coverage of up to $25,000 per employee are not taxable.

(The 1994 budget eliminated the tax exemption for employer-paid premiums for group term life insurance of up to $25,000, effective July 1, 1995.)

Non-taxation of RCMP pensions/compensation for injury, disability or death

Pension payments, allowances and other compensation received in respect of an injury, disability or death associated with service in the Royal Canadian Mounted Police are non-taxable.

The estimates are based on Public Accounts data.

Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)

These amounts are not included in income for tax purposes.

The estimates are based on Public Accounts data.

Non-taxation of veterans' disability pensions and support for dependants

These amounts are not included in income for tax purposes.

The estimates for this item are based on Public Accounts data.

Treatment of alimony and maintenance payments

Payments by a taxpayer to a divorced or separated spouse are deductible to the payer and taxable in the hands of the recipient.

This treatment represents a tax expenditure because it departs from the benchmark system established for purposes of this report. Under this benchmark tax system, deductions are permitted only for expenses incurred in order to earn income and transfers from other individuals are not included in income.

The estimates for this item are computed as the value of the deduction to the payer less the tax collected from the recipient.

Age credit

Individual taxpayers aged 65 or over were entitled to claim a tax credit of 17 per cent of $3,482. Unused portions may be transferred between spouses.

(Following the 1994 budget, the age credit is now subject to an income test.)

Pension income credit

A 17-per-cent tax credit is available on up to $1,000 of certain pension income. The unused portion of the credit may be transferred to a spouse.

Saskatchewan pension credit

Contributions to the Saskatchewan Pension Plan are deductible up to the lesser of $600 or the amount of unused RRSP room in a particular year.

Registered retirement savings plans/registered pension plans

The federal revenue forgone due to the provisions pertaining to registered retirement savings plans (RRSPs), registered pension plans (RPPs) and deferred profit sharing plans (DPSPs) is a function of three components: the deductibility of contributions to such plans; the non-taxation of investment income accrued within such plans, and the income inclusion of RRSP/RPP withdrawals which reduces the cost resulting from the previous two. Individuals benefit from a deferral of tax on amounts contributed and on investment income. Also, there is an absolute tax saving to the extent that the tax rate on withdrawals is below that faced at the time of contributions. As noted in the introduction, the estimates provided in the table are made on a current cash-flow basis. That is, they measure the impact on the deficit of the tax measure in each of the years under consideration.

In 1991, a new system of comprehensive limits on tax-assisted retirement saving took effect. Under this system, saving in RRSPs, RPPs and DPSPs is governed by a comprehensive limit of 18 per cent of earnings up to a dollar amount. In more detail, the limits for 1992 and 1993 were as follows:

- For defined benefit pension plans, the limits were the same as in 1990: that is, there were no fixed limits on employee contributions while employer contributions were restricted to the amounts necessary to fully fund the promised benefits. Annual benefits under these pension plans are limited to the lesser of $1,722 and 2 per cent of best average earnings for each year of pensionable service.
- For RRSPs, contributions were limited to 18 per cent of earned income for the preceding taxation year to a dollar maximum ($12,500 for 1992 and for 1993), minus a Pension Adjustment (PA). The PA was based on RPP or DPSP benefits earned by plan members in the previous taxation year. For a money purchase RPP or a DPSP, the PA is simply the total contribution made by or on behalf of a plan member in the year. For a defined benefit RPP, the PA is a measure of the benefits earned in the year, calculated according to a prescribed formula.

In 1992, the federal government introduced the Home Buyers' Plan as a temporary measure. It allowed all individuals to withdraw up to $20,000 from their RRSPs on a tax-free basis to purchase a home. Amounts withdrawn under the Home Buyers' Plan are to be repaid to the individual's RRSP on an interest-free basis over a period of 15 years. Amounts that are not repaid are included in the individual's income for tax purposes. (In 1994, this measure was made permanent, but restricted to first-time home-buyers only.) The impact of the Home Buyers' plan on the cost of RRSPs is expected to be small.

It should be noted that the RRSP/RPP estimates do not reflect a mature system because contributions currently exceed withdrawals. Assuming a constant tax rate, if contributions equalled withdrawals, only the non-taxation of investment income would contribute to the net cost of the tax expenditure. As time goes by and more retired individuals have had the opportunity to contribute to RRSPs throughout their lifetime, the gap between contributions and withdrawals will shrink and possibly even become negative. The upward bias in the current cash flow estimates can therefore be expected to decline.

The estimates may not reflect the benefit to a particular individual in any given year because the individual is typically either a contributor or withdrawer at a point in time but not both. In order to estimate the benefit to a particular individual one could calculate the difference in disposable income between a situation in which that individual invests in an RRSP/RPP and one in which that individual invests in a non-sheltered savings instrument.

Data used to estimate the value of these measures were taken from the personal income tax model, unpublished data from Statistics Canada, and from Statistics Canada publications Trusteed Pension Funds (Cat. 74-201) and Pension Plans in Canada (Cat. 74-401), as well as from the Bank of Canada Review.

Deferred profit-sharing plans

Employers may make tax-deductible contributions to a profit-sharing plan on behalf of their employees. These amounts are taxable in the hands of the employees when withdrawals are made from the plan. The employer's contribution cannot exceed the lesser of $3,500 per employee (less any contributions by the employer to an RPP in respect of the employee) or 20 per cent of the employee's earnings.

No data are available.

Non-taxation of up to $10,000 of death benefits

Up to $10,000 of death benefits paid by an employer to the spouse of a deceased employee is non-taxable.

No data are available.

Non-taxation of investment income on life insurance policies

The investment income earned on some life insurance policies is not taxed as income to the policy holder. Instead, for reasons of administrative convenience, insurance companies are subject to tax on such earnings.

(See Appendix B for a further description of this measure and estimates of the cost of the tax expenditure involved.)

Small Business

$500,000 lifetime capital gains exemption for small business shares

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption and the $500,000 lifetime capital gain exemption on qualified farm property have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains and this is the approach adopted in the benchmark system. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income. Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted from taxable capital gains in future years.

Labour-sponsored venture capital corporations credit

A 20-per-cent tax credit is available on amounts invested in Labour-Sponsored Venture Capital Corporations, to a maximum credit of $1,000.

Deferral through 10-year capital gain reserve

If proceeds from the sale of small business shares to children, grandchildren or great-grandchildren are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year creating a maximum 10-year reserve period. This contrasts with the treatment of most other property where the maximum reserve period is five years.

Other Items

Non-taxation of income from War Savings Certificates/Victory Bonds

Income earned on these instruments is non-taxable.

The estimates are based on Bank of Canada data.

Non-taxation of capital gains on principal residences

Capital gains realized on the disposition of a taxpayer's principal residence are non-taxable. The capital gains were determined using Multiple Listing Service (MLS) housing prices, adjusted to include expenditures on capital repairs and major additions and renovations, obtained from Statistics Canada's Consumer Expenditure Survey. The holding period for principal residences was derived from 1981 Census data.

Estimates for this item are provided for both partial and full inclusion rates for capital gains.

Non-taxation of income from the Office of the Governor General

This income is exempt from personal income taxation.

Data were provided by the Office of the Governor General.

Assistance for prospectors and grubstakers

Where a prospector or grubstaker disposes of mining property to a corporation in exchange for shares in that corporation, the tax liability is deferred until the subsequent disposition of the shares. At that time, only three-quarters of the amount for which the mining property was transferred to the corporation need be included in income.

Charitable donations credit

A tax credit of up to 20 per cent of net income is available for donations made to registered charities. Donations in excess of the 20-per-cent limit may be carried forward for up to five years. The 20-per-cent restriction does not apply to certain gifts of cultural property. The credit is 17 per cent on the first $250 of total donations (including gifts to the crown) and 29 per cent on donations in excess of $250.

(The 1994 budget reduced the threshold at which the 29-per-cent rate applies from $250 to $200, starting in the 1994 tax year.)

Gifts to the Crown credit

A tax credit is available for gifts to the Crown. The credit is 17 per cent on the first $250 of total donations (including charitable donations) and 29 per cent on donations in excess of $250. Unused contributions may be carried forward for up to five years.

(The 1994 budget reduced the threshold at which the 29-per-cent rate applies from $250 to $200, starting in the 1994 tax year.)

Political contributions credit

A credit is available for donations to registered federal political parties. The credit is 75 per cent of the first $100 of contributions, 50 per cent on the next $450 of contributions and 33⅓ per cent on the next $600. The maximum credit claimable in any year is $500.

Non-taxation of income of Indians on reserves

The income of Indians is exempt if located on a reserve.

No data are available.

Non-taxation of gifts and bequests

Gifts and bequests are not included in the income of the recipient for tax purposes.

No data are available.

Memorandum Items

Non-taxation of allowances for certain public officials

Members of Parliament (MPs), MLAs, Senators and some other public officials (such as elected municipal officials and judges) receive flat allowances for expenses incidental to their duties. These amounts are not included in income for tax purposes.

This provision is a memorandum item because it is not possible to distinguish the proportion of these allowances which is used for personal consumption and that which is for work-related expenses.

Data are available only for the non-taxable allowances provided to MPs, MLAs, and Senators. This information is found in the publication *Canadian Legislatures* and *The Canadian Parliamentary Guide*.

Non-taxation of allowances for diplomats and other government employees posted abroad

Diplomats and other government employees posted abroad receive a non-taxable income supplement to cover the additional costs associated with living outside Canada.

Information on total allowances was obtained from Treasury Board.

Child care expense deduction

A portion of child care expenses is deductible if incurred for the purpose of earning business or employment income, taking an occupational training

course or carrying on research for which a grant is received. For 1992, the deduction could not exceed the lesser of $4,000 per child if the child was under age seven or was disabled, or $2,000 per child between seven and 14 years of age, or two-thirds of earned income for the year. These amounts were raised to $5,000 and $3,000 respectively in 1993. The deduction must generally be claimed by the spouse with the lower income. However, the higher-income parent may claim a deduction if the lower-income parent is infirm, confined to a bed or a wheelchair, in prison, or attending a designated educational institution on a full-time basis.

Attendant care expense deduction

A disabled individual can deduct the cost of unreimbursed care provided by a part-time attendant, if such an expense is required to enable the individual to work. The deduction cannot exceed the lesser of $5,000 or two-thirds of earned income for the year.

Moving expense deduction

All reasonable moving expenses (e.g., transportation, meals and temporary accommodations) are deductible from income received after the move if the taxpayer moves at least 40 kilometres closer to the place of employment or study. Moving expense reimbursements provided by employers are not included in income.

The estimates do not include non-taxable reimbursements received from employers.

Deduction of carrying charges incurred to earn income

Interest and other carrying charges, such as investment counselling fees and safety deposit box charges, incurred to earn business or investment income are deductible.

Some might consider the deductibility of such expenses to be a tax expenditure because of the tax deferral arising from the up-front deduction of expenses associated with the earning of income which will not be taxed until received possibly in future years. Others would hold that carrying charges are incurred for the purpose of earning income and therefore represent part of the benchmark income tax system.

Deduction of meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment is part of

a package price which includes amounts not subject to the 80-per-cent limitation, for instance the fee for a conference, the taxpayer is required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation.

(The 1994 budget reduced the deductible portion of meals and entertainment expenses from 80 per cent to 50 per cent, starting in the 1994 tax year.)

Deduction of farm losses for part-time farmers

Individuals whose major source of income is not farming are allowed to deduct farm losses up to an annual maximum of $8,750 against other income.

Part-time farm losses which are not deductible in the current year may be carried back three years and forward ten years to deduct against farm or non-farm income. The estimates include the cost of these carry-overs.

Farm and fishing loss carry-overs

Farm and fishing losses may be carried back three years and forward ten years. Most other business losses may be carried forward seven years.

The only data which are available are prior years' losses carried forward to the current year. In this regard, the estimates do not include current year losses carried forward to the future or back to the past, nor do they include future losses carried back to the taxation year in question. The estimates also do not include losses carried over by part-time farmers.

Capital loss carry-overs

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. The estimates do not include current year losses carried forward to the future or back to the past nor do they include future losses carried back to the taxation year in question.

Non-capital loss carry-overs

Non-capital losses may be carried back three years and forward seven years to offset other income.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost estimates may understate the true amount of revenue forgone because they do not include current year losses carried forward to the future or back to the past nor do they include future losses carried back to the taxation year in question.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of ⅔ of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province. The mandatory nature of the tax paid to the provinces leads to the classification of this provision as expenses incurred to earn income.

The estimates are based on data from Revenue Canada.

Deduction of accelerated tax depreciation

The depreciation allowable for tax purposes is called capital cost allowance (CCA). It may differ from true economic depreciation. A tax deferral may thus be created when the tax deductions in the early years of the life of an asset exceed the actual depreciation in the value of the asset. The difference is captured upon subsequent disposition of the asset.

The estimates are based upon a comparison of CCA and book depreciation. Since book depreciation does not necessarily represent the true economic depreciation, it is not possible to calculate the value of this measure with a high degree of accuracy. Consequently, this deduction is reported as a memorandum item. A more detailed explanation is provided in Appendix B.

Deduction of resource-related expenditures

Individuals are entitled to deduct certain expenses associated with the exploration for, and development of, Canadian natural resources. These expenses are deductible if the taxpayer either engages directly in these resource activities or provides financing to a resource company which, in turn, "flows through" the tax deductions to the taxpayer.

A tax expenditure arises when a flow-through share investor is able to use deductions for exploration and development more quickly than would otherwise have been possible by the resource company that actually undertook these expenditures. However, the available data do not permit a separation of expenses which are flowed through to investors and those which are incurred directly by the taxpayers. Accordingly, only some portion of resource-related expenditures deducted represents a true tax expenditure: this explains their treatment as a memorandum item.

Deduction of other employment expenses

Employee expenses are generally not deductible. However, specific employment expenses (e.g., automobile expenses, cost of meals and lodging for certain transport employees, legal expenses paid to collect salary) are deductible in certain circumstances in the computation of income.

This provision is a memorandum item because it is not possible to distinguish the proportion of these expenses which is used for personal consumption and that which is incurred in order to earn income.

Deduction of union and professional dues

Union and professional dues are fully deductible from income.

The mandatory nature of these payments leads to their classification as expenses to earn income.

Unemployment insurance contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for unemployment insurance contributions. Employer-paid premiums are not included in income.

The mandatory nature of unemployment insurance contributions leads to their classification as expenses incurred to earn income.

Canada and Quebec Pension Plan contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for Canada/Quebec Pension Plan contributions by both employees and the self-employed. Employer-paid premiums are not included in income.

Again, since CPP/QPP contributions are mandatory, they are classified as expenses incurred to earn income.

Foreign tax credit

In order to avoid double taxation, a tax credit is provided in recognition of income taxes paid in foreign countries.

Dividend gross-up and credit

Dividends received from taxable Canadian corporations are "grossed-up" by a factor of one-quarter and included in income. A tax credit equal to 13.33 per cent of the grossed-up amount is then provided, in recognition of taxes paid at the corporate level. These provisions contribute to the integration of the corporate and personal income tax systems.

Basic personal credit

All taxpayers qualify for a basic personal credit equal to 17 per cent of $6,456 in 1992 and 1993.

Non-taxation of capital dividends

Private corporations may distribute the exempt one-quarter of any realized capital gains accumulated in their "capital dividend account" to their shareholders in the form of a capital dividend. This dividend is non-taxable. This measure is reported as a memorandum item since it contributes to the integration of the taxation of corporate and personal income.

No data are available.

APPENDIX B
DESCRIPTION OF CORPORATE INCOME TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a simplified reference. It should be noted that the explanations refer to the 1991 and 1992 taxation years. Since that time, a number of provisions have been altered. Some of the more significant changes to these provisions made since 1992 are indicated in the text.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the corporate income tax model, which is maintained by Revenue Canada. For example, certain estimates, such as the deductibility of carrying charges on land, were calculated using other data sources.

Tax Rate Reductions

The following items are measures that reduce the statutory tax rate faced by a corporation. They are tax expenditures because income is taxed at a rate other than the generally applicable tax rate.

Low tax rate for small businesses

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for a small business tax rate reduction, known as the small business deduction. This deduction lowers the basic federal tax rate on the first $200,000 of active business income of CCPCs by 16 percentage points – from 28 per cent to 12 per cent.

(The 1994 budget announced changes that make some large CCPCs ineligible for the small business benefit.)

Low tax rate for manufacturing and processing

A tax reduction is provided on Canadian manufacturing and processing (M&P) income not subject to the small business deduction. This reduction takes the form of a non-refundable credit on income earned and has the effect of lowering the tax rate on M&P income. In the period under review, the reductions from the general 28-per-cent rate were as follows:

For that portion of a corporation's taxation year between

July 1, 1990 – June 30, 1991:	4 percentage points
July 1, 1991 – December 31, 1992:	5 percentage points

The amounts reported in the tables estimate the additional revenues that would have been collected by the government if M&P income had been taxed at the general corporate rate.

(Since 1994, Canadian manufacturing and processing income is taxed at a 21-per-cent federal rate, a seven percentage point reduction from the general rate.)

Low tax rate for credit unions

Although not a private corporation for most purposes, a credit union is eligible for the small business deduction (i.e. 16 per cent of its taxable income). A credit union with more than $200,000 of active business income may be eligible for a deduction of 16 per cent of its taxable income where the total income of the corporation since 1971 is less than the corporation's "maximum cumulative reserve", which is equal to 5 per cent of amounts owing to members (including members' deposits and share capital). The purpose of this additional deduction is to permit a credit union to accumulate capital on a tax-preferred basis up to a maximum of 5 per cent of deposits and capital.

Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations

The branch tax is imposed on that portion of the income of non-Canadian corporations derived from the carrying on of business in Canada through a branch. The rate is 25 per cent, but this is frequently reduced by reciprocal tax treaties to 15 per cent or 10 per cent.

A corporation is exempt from the branch tax if it is:

(a) a bank;

(b) a corporation whose principal business is:

  (i) the transportation of persons or goods,

  (ii) communications,

  (iii) mining iron ore in Canada, or

(c) an exempt corporation such as a registered charity.

No data are available.

Exemption from tax for international banking centres

A prescribed financial institution's branch or office carrying on certain business in the city of Montreal or Vancouver may qualify as an International Banking Centre (IBC) and therefore be exempt from tax on its income. To qualify as an IBC under the Income Tax Act, the branch's income must be derived from accepting deposits and making loans to non-residents. This measure, introduced in 1987, is a tax expenditure because a financial institution can undertake business with non-residents through a Canadian permanent establishment without being subject to Canadian income taxes.

No data are available.

Tax Credits

The following measures are credits against federal taxes otherwise payable. They are considered to be tax expenditures because they provide credits to businesses which engage in a particular activity such as research and development or undertake an investment in a designated region of the country. The federal government forgoes revenue because tax credits can reduce federal revenues in two ways. They may be:

- used to offset federal income taxes otherwise payable, and
- fully or partially refundable for some CCPCs.

Investment tax credits (ITCs)

The Income Tax Act provides an ITC for:

- investment in eligible depreciable property that is used in certain regions of the country, and
- expenditures on Scientific Research and Experimental Development (SR&ED).

An ITC provides beneficial treatment to taxpayers, depending on their size, the region of the country in which they operate and the nature of their investment. The amount of the credit is calculated as a percentage of the cost of eligible expenditures. For taxation years 1991 and 1992, separate estimates are provided for the regional and SR&ED investment tax credits.

Corporations may reduce but, generally, not eliminate federal taxes payable by the amount of ITCs available on certain eligible expenditures. Three-quarters of a taxpayer's federal tax payable in a taxation year may be offset by ITCs. (This latter limitation was removed for taxation years commencing after 1993.) For CCPCs, a special rule permits the full offset of federal tax on their business income eligible for the small business deduction. The carry-forward period for unused credits is 10 years. The surtax still remains subject to the three-quarters limitation. The carry-back period is three years.

Credits utilized or refunded reduce either the undepreciated capital cost of the asset for capital cost allowance (CCA) purposes or, in the case of SR&ED, the SR&ED pool. Credits earned in respect of a property acquired after January 1, 1990 and not immediately available for use may not become claimable until the property is available for use or has been held by the taxpayer for two years.

Refundability of ITCs

A qualifying corporation that cannot use ITCs in the current year because the credits earned exceed the amount that could be used to offset taxes otherwise payable can use the excess to obtain current year cash refunds of either 40 per cent or 100 per cent, depending on the type of eligible expenditure. A qualifying corporation for purposes of the refund is a CCPC

which, together with any associated corporations, had taxable income not exceeding $200,000 in the preceding year. These latter rules were modified in the 1993 and 1994 federal budgets.

For qualifying CCPCs, the refundability rate of ITCs that cannot be used in the year they are earned is generally 40 per cent. A qualifying CCPC may receive a 100-per-cent refund on its share of ITCs earned at the 35-per-cent rate in respect of up to $2 million of annual current SR&ED expenditures. All refunds reduce the amount of ITC for carry-over purposes.

Issues in calculating the value of ITCs

To maintain consistency with the other estimates in this document, the amounts reported in the table estimate the forgone revenue for the year in question from each ITC. In other words, the estimates show how much additional revenue would have been collected by the government in the year if the ITC had been eliminated in that particular year. To do this, the amount of ITCs used in the year had to be separated into two components: ITCs that were both earned and used in the year, and ITCs that were earned in prior years but used in the year. The former represents credits used from current year expenditures. Included in these estimates are the costs of any applicable refunds on ITCs earned. The latter item, ITCs earned in the past but not used until the current year, is itemized separately.

Another perspective on the revenue cost of each ITC is obtained by looking at the amount of ITCs earned in 1991 and 1992. This information is provided in the table below. However, it should be recognized that ITCs earned in the year are not necessarily used in the year – they may be used in a subsequent or previous year, subject to the carry-over rules. As a result, had the ITCs been eliminated, government revenues for the year would not have been higher by the amounts shown in the table below since it may take a number of years for ITCs earned in a year to be used by the taxpayer to reduce federal taxes.

Investment tax credits earned in the year

	1991[1]	1992
	(millions of dollars)	
SR&ED ITC[2]	1,093	1,155
Atlantic Canada ITC	100	155
Special ITC	85	28
Cape Breton ITC	4	3
Exploration Tax Credit	2	n.a.
Small Business ITC	n.a.	5

[1] The 1991 figures in this table are based on final data and may differ from the figures in last year's edition of this document, which were based on preliminary data.

[2] Of this amount, about $15 million may be attributed to the regional component in each of the years 1991 and 1992.

Scientific research and experimental development investment tax credit

There are three tax credit rates; a general rate of 20 per cent, a 30-per-cent rate for the Atlantic provinces and the Gaspé, and an enhanced rate of 35 per cent for qualifying CCPCs – those with prior year taxable income less than $200,000. (As a result of a 1994 budget proposal, the 30-per-cent rate will not be available after 1994.) The maximum amount of SR&ED expenditures that can earn ITCs at the 35 per cent in a year is $2 million.

(The rules relating to this expenditure limit were modified in the 1993 and 1994 federal budgets.)

Atlantic Canada investment tax credit (AITC)

The 15-per-cent ITC is available for qualified property in the Atlantic region: Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, the Gaspé region, and their associated offshore areas. (This rate has been reduced to 10 per cent for tax years ending after 1994.)

The AITC applies to eligible expenditures on new buildings, machinery and equipment employed in the following qualifying activities: farming, fishing, logging, mining, oil and gas, and manufacturing and processing.

The AITC is refundable at a 40-per-cent rate for qualifying CCPCs and individuals. It is not refundable for other taxpayers.

Special investment tax credit (SITC)

The ITC rate was 30 per cent in selected prescribed regions. (The February 1994 budget eliminated the 30-per-cent Special ITC, effective as of 1995, subject to some grandfathering provisions.)

Eligible SITC areas are in all provinces including north-eastern British Columbia, north-western Alberta, northern Saskatchewan, most of Manitoba, northern Ontario, northern Quebec and the Gaspé region, and areas of Atlantic Canada.

Qualifying activities are defined under the Regional Development Incentives Act (RDIA) and its regulations, and generally include manufacturing and processing facilities located in a qualifying region with the exception of certain primary processing of natural resources.

Cape Breton investment tax credit (CBITC)

The Cape Breton credit was 45 per cent after 1988 and was applicable to eligible equipment acquired after May 23, 1985 and before 1993.

Exploration tax credit (ETC)

A 25-per-cent ITC was available for qualified Canadian exploration expenditures – these expenditures are incurred in respect of a well costing in excess of $5 million. Credits were earned on costs incurred between December 1, 1985 and December 31, 1990.

Small business investment tax credit (SBITC)

A non-refundable 10-per-cent ITC is available for eligible machinery and equipment acquired after December 2, 1992 and before 1994 by unincorporated businesses, partnerships, and Canadian-controlled private corporations, other than those subject to the Large Corporations Tax.

ITCs claimed in current year but earned in prior years

These are tax credits that were earned by corporations in previous years but not claimed until the current year. There is a revenue cost to the government when the credits are used by corporations to reduce federal taxes payable. While the aggregate amount of these credits is known, there is not enough information available to identify separately the amounts for each credit.

Political contributions tax credit

A non-refundable tax credit is available for contributions to registered federal political parties or candidates. The credit is 75 per cent of the first $100 contributed, 50 per cent on the next $450 contributed and 33⅓ per cent on the next $600 contributed. The maximum credit is $500 and would be available when the taxpayer has contributed $1,150.

This measure constitutes a tax expenditure because political contributions are not incurred to earn income.

Exemptions and Deductions

The following exemptions and deductions are identified as tax expenditures because they deviate from the benchmark tax system.

Partial inclusion of capital gains

Three-quarters of net realized capital gains are included in income. The cost of the tax expenditure is the amount of additional tax that would have been collected had the remaining one-quarter of the capital gains been included in income. However, this amount is likely an overestimate of the true amount of the cost of this tax expenditure. To the extent that the capital gains are from shares that have increased in value due to retained earnings, and which have already been taxed at the corporate level, the partial inclusion of the capital gains provides some relief from double taxation and, therefore, should be part of the benchmark tax system.

Resource allowance

Deductibility of Crown royalties and mining taxes

The current tax system does not permit a deduction for Crown royalties or mining taxes. The deduction has been denied since May 6, 1974. From 1974 to the end of 1975, oil and gas and mining companies were eligible for a resource tax abatement. This tax abatement provided a lower rate of tax on oil and gas and mining income. A resource allowance was introduced in the June 1975 budget to replace the abatement effective 1976.

There is a potential *negative* tax expenditure associated with this item. A *negative* tax expenditure implies that the government is collecting more income taxes than would have occurred in the benchmark system. The issue arises as to whether the benchmark tax system would include a deduction for all Crown royalties and mining charges. Two generic types of non-deductible crown charges levied by governments on the extraction of natural resources can be identified. There are simple royalty systems where the charge is based only on gross revenues. There are also more complex systems of crown levies that are based on net resource profits, i.e. after the deduction of numerous costs, including capital, operating costs and sometimes a return on capital employed.

In the case of the former type of charge, the benchmark system **would** include a deduction because these royalties are analogous to costs of production. However, the benchmark tax system **would not** include a deduction for the latter type of profit-related crown royalties and mining income taxes because they are structured more like income taxes. Provincial income taxes are not considered to be a deductible expense in the benchmark system.

The calculations shown here represent the federal corporate income tax revenues generated by denying deductibility and no attempt has been made to divide the royalties into the two categories described above. This is, in part, due to the fact that many royalty systems include characteristics of both a gross and net calculation.

Resource allowance

Since 1976, the tax system has provided a resource allowance equal to 25 per cent of a taxpayer's annual resource profits, computed after operating costs and capital cost allowances, but before the deduction of exploration expenses, development expenses, earned depletion and interest expenses. The resource allowance is provided in lieu of the deductibility of Crown royalties, mining taxes and other charges related to oil and gas or mining production. The measure allows the provinces room to impose royalties or mining taxes on the production of natural resources while maintaining the integrity of the federal income tax base. The value of the tax expenditure for the resource allowance is the federal tax revenue forgone resulting from allowing 25 per cent of resource profits to be deductible for tax purposes.

Earned depletion

Earned depletion is an additional deduction from taxable income of certain exploration and development expenditures and other resource investments. Taxpayers were entitled to earn an extra deduction of up to 33⅓ per cent of exploration and development expenses or the costs of assets related to new mines or major expansions. Deductions for earned depletion were generally limited to 25 per cent of the taxpayer's annual resource profits. As in the case of Canadian exploration expenses (CEE) or Canadian development expenses

(CDE), earned depletion could be pooled, i.e. placed in a special account, and any remaining balance deducted in a future taxation year with no time limit on carrying forward these amounts.

Earned depletion and mining exploration depletion deductions were eliminated as of January 1, 1990. No additions to the earned depletion pool were permitted after December 31, 1989, but deductions can still be made on the basis of existing depletion pools.

Under the benchmark tax system, a deduction for earned depletion would not be available.

Deductibility of charitable donations

Donations made by corporations to registered charities are deductible in computing taxable income. This deduction is limited to 20 per cent of net income but unused deductions may be carried forward for up to five years.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Gifts to the Crown

A corporation may deduct the full amount of any gift it makes to Canada or a province. Unlike charitable donations, the amount deductible is not limited to 20 per cent of net income. However, the deduction may not exceed the amount of income in a particular fiscal year. Amounts not deducted can be carried forward for up to five years.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Non-deductibility of advertising expenses in foreign media

Expenses for advertising in non-Canadian newspapers or periodicals or on non-Canadian broadcast media cannot generally be deducted for income tax purposes if they are directed primarily to a market in Canada. Deducting the cost of advertising in foreign periodicals or TV stations is not restricted if the advertising is to promote sales in foreign markets.

This treatment results in a negative estimate since the deduction of an expense incurred to earn income is denied. Under the benchmark tax system, advertising expenses in foreign media that were incurred to gain or produce income from a business or property would be deductible whether targeted at foreign or domestic markets.

No data are available.

Non-taxation of provincial assistance for venture investments in small business

Normally, government assistance received by a corporation is either included in the corporation's income or subtracted in computing the cost basis of the assets to which the assistance relates for capital cost allowance (CCA) purposes. There are a number of exceptions to this rule, including provincial assistance provided for venture capital investment under specified provincial programs. Under the benchmark tax system, this type of assistance would be included in the corporation's income or the cost basis of the assets would be reduced.

No data are available.

Deferrals

The tax expenditures in this section provide for a deferral of income taxes from the current to a later taxation year. They have been valued on a cash-flow basis, i.e. the forgone tax revenue associated with the additional net deferral in the year. The alternative way of valuing deferrals would be to calculate the value of the interest-free loan that is provided to the taxpayer when taxes are deferred to a later year.

Fast write-off for capital equipment used for SR&ED

Capital expenditures for eligible equipment used to carry out SR&ED may be fully deducted in the year of acquisition. In the absence of this provision, these amounts would have been depreciated over several years (subject to CCA rules). The CCA rules represent the benchmark tax system in which expenditures that are capital in nature and designed to produce income in the future are depreciated over the period in which the income is expected. The tax expenditure estimate represents the impact of the fast write-off of SR&ED expenditures of a capital nature in the year they are made.

The current publication includes a revision of the method of estimating the tax expenditures for this item. These new estimates use information now available from Revenue Canada's scientific research and experimental development (T661) database. The industry distribution for 1991 and 1992 (preliminary) is included in Table 2. Tax expenditures for fast write-offs for capital equipment used for SR&ED were $48 million in 1989; $52 million in 1990, $72 million in 1991; and $53 million in 1992.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income.

Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to a capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted against uncertain taxable capital gains in the future.

The current publication reflects a revision in the method of estimating tax expenditures for this item. As a result, the tax expenditures associated with this measure are now estimated as $18 million for 1989; $32 million for 1990; $39 million for 1991; and $44 million for 1992. The industry distribution for 1991 and 1992 (preliminary) is included in Table 2.

Deductibility of carrying charges on land

Before 1988, carrying charges on vacant land and “soft costs” were capitalized and amortized over the life of the asset or deducted when related revenue was earned. There were two important exceptions to this rule. First, carrying charges on vacant land were fully deductible if the land was used as part of the business of selling or developing land. Second, land development corporations were not required to capitalize soft costs.

These exceptions were phased out over a five-year period starting in 1988 and ending in 1992. Consequently, in 1991, 20 per cent of these costs remained fully deductible and none were deductible in 1992.

A deduction in respect of land carrying costs up to an amount equal to $1 million times the prescribed interest rate for the year has been available for small developers since 1988. This deduction must be shared by related companies.

Under the benchmark tax system, carrying charges and soft costs would generally be treated as part of the cost of the property and would be deducted when the property was sold.

Data on raw land reported on financial statements were used to estimate the cost of the tax expenditure. However, no data are available to estimate the small developers’ deduction.

Available for use

Before 1990, taxpayers were allowed to claim CCA and ITCs in respect of property not yet producing income (i.e. property not in use). In many cases, this resulted in a significant mismatch of revenues and expenses, which gave rise to a tax deferral. This was a tax expenditure because taxpayers were allowed to claim deductions and tax credits on property before it was put in use.

As of 1990, taxpayers may claim CCA and ITCs on eligible property at the earlier of the time it is put in use or in the second taxation year following the year of acquisition. Consequently, for the 1991 taxation year, the value of the tax expenditure was nil because the taxpayer would not be permitted to claim

CCA and ITCs on property that was acquired but not yet available for use. Property that became eligible for CCA and ITCs by virtue of the two-year deferral rule could give rise to a tax deferral (and this would constitute a tax expenditure) in 1992, if the property had been acquired in 1990.

No data are available as assets are pooled into classes and are not accounted for separately. Furthermore, they are not identified as being "available for use" or "not available for use".

Capital gains taxation on realization basis

Capital gains are taxed upon the disposition of property and not on an accrual basis. This treatment results in a tax deferral. Under the benchmark tax system, capital gains would be fully included in income as they accrue.

No data are available.

Expensing of advertising costs

Advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future. This treatment results in a deferral of tax. Under the benchmark tax system, the expenses would be amortized over the benefit period. While the benefits of advertising may extend beyond the current year, determining useful lives in most cases is not feasible.

No data are available.

Cash basis accounting

Farming and fishing corporations may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues.

No data are available.

Flexibility in inventory accounting

Farm corporations using the cash basis method of accounting are allowed to depart from it with regard to their inventory. A discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farm corporations to avoid creating losses which, if carried forward, would be subject to the time limitation. Thus the tax expenditure provides tax relief to the extent that the losses would otherwise have been subject to the time limitations.

No data are available.

Deferral of income

On grain sales

Farmers may make deliveries of grain before the year end and be paid with a ticket that may be cashed only in the following year. The payment for deliveries of grain is included in income only when the ticket is cashed, thereby providing a deferral of taxes. Under the benchmark tax system, income would be taxed on an accrual basis.

No data are available.

On destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

No data are available.

Holdback on progress payments to contractors

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g., 10 to 15 per cent) is often held back until the entire project is satisfactorily completed. The amount held back need not be brought into the income of the contractor until the project to which it applies is certified as complete, rather than when earned as would be required in the benchmark tax structure. Where a contractor, in turn, withholds an amount from a subcontractor, costs equal to the amount of the holdback are not considered to have been incurred by the contractor and are not deductible until paid. The net impact of these two measures on a given contractor's tax liability depends on the ratio of holdbacks payable to holdbacks receivable. If holdbacks receivable are greater than holdbacks payable, there is a deferral of tax. If holdbacks payable exceed holdbacks receivable, there is a prepayment of taxes.

Increases in net holdbacks receivable or decreases in net holdbacks payable result in a positive estimate of the cost of the tax expenditure. Increases in net holdbacks payable or decreases in net holdbacks receivable result in a negative estimate.

Deferral of tax from use of billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as

incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

International

Non-taxation of life insurance companies' world income

All Canadian corporations except Canadian multinational life insurers are taxed on their worldwide income. Canadian multinational life insurers are taxed only on their profits from carrying on a life insurance business in Canada using special rules in the income tax regulations.

The cost of this tax expenditure was estimated from tax returns and information available from the Office of the Superintendent of Financial Institutions.

Exemptions from non-resident withholding tax

Canada, like other countries, imposes a withholding tax on various types of income paid to non-residents. The basis for this tax rests on the internationally accepted principle that a country has the right to tax income that arises or has its source in that country. The types of income subject to non-resident withholding tax include: certain interest, dividends, rents, royalties and similar payments; management fees; estate and trust income, alimony and support payments; as well as certain pension, annuity and other payments.

Over time, as the benefits of freer trade in capital, goods and services have been increasingly recognized, countries including Canada have adjusted their tariff and tax structures to remove impediments to international transactions. Part of this adjustment has been the reduction of non-resident withholding tax on certain payments.

Canada's statutory non-resident withholding tax rate is 25 per cent. However, the rate is lowered and exemptions provided for certain payments through an extensive network of bilateral tax treaties. These rate reductions, which apply on a reciprocal basis, differ depending on the type of income and the tax treaty country.

The Income Tax Act also provides for a number of unilateral exemptions from withholding tax including: exemptions for interest payments on government debt; interest payments to arm's length persons on long-term corporate debt; interest payments to arm's length persons on foreign currency deposits with branches of Schedule I banks; and, royalty payments for the use of copyright.

Lower withholding taxes can reduce the cost to Canadian business of accessing capital and other business inputs from abroad. For example, a lower Canadian withholding tax on interest payments to non-residents can reduce the cost of accessing foreign capital in cases where foreign creditors

raise the interest rate charged to cover payment for withholding tax. The withholding tax exemption for interest on government debt lowers the borrowing costs of all governments in Canada, thereby lowering the tax burden for all Canadians. Similarly, a reduced withholding tax on royalty payments can reduce the cost of accessing foreign technology and other property and services, and thereby enhance the competitiveness of Canadian businesses requiring these inputs.

The cost estimates of the tax expenditures associated with withholding tax exemptions for certain royalties, interest, dividends and management fees paid to non-residents were derived from a detailed survey of payments to non-residents and withholding tax collections on those payments for 1993. The cost estimates were derived by applying treaty withholding tax rates (in the case of payments to a country with which Canada had a tax treaty in 1991/1992) or the statutory 25 per cent withholding tax rate (in the case of payments to non-treaty countries), that would otherwise apply in the absence of an exemption, to observed payments data under the benchmark assumption used throughout this publication of no behavioral response to the hypothetical removal of existing withholding tax exemptions.

This benchmark assumption of no behavioral response is particularly difficult to sustain for this type of tax. Foreign providers of capital, technology, and other property and services in most cases are unwilling to bear withholding tax given that they do not pay such a tax when supplying other markets. If a withholding tax were to be imposed, they would either require that the tax be shifted-back to the Canadian borrower or user of property or services in the form of higher charges (which in many cases could not be absorbed), or they would bypass Canada in favour of other foreign markets where such a tax does not exist, again implying increased financing and other business costs to Canadians. Indeed, these same competitiveness considerations have led to the introduction of a number of withholding tax exemptions both in Canada and in other countries.

Thus, these particular tax expenditure estimates cannot be interpreted as additional revenues that could be collected from non-residents if the withholding tax exemptions were removed, since the removal of the exemptions would generally involve the elimination of the tax base.

Exemption of foreign shipping and aircraft companies from Canadian income tax

Non-resident shipping corporations engaged primarily in international traffic are treated as non-resident under the Income Tax Act. Similarly, by international agreement, non-resident incorporated airlines engaged primarily in international traffic are treated as non-resident. In both cases, the exemption applies only if the non-resident's home country gives Canadians a comparable exemption. The cost of the tax expenditure is then the Canadian tax that would otherwise be payable on profits related to their Canadian business.

No data are available.

Other Tax Expenditures

The following tax measures are not directly related to the corporate business sector in Canada.

Transfer of income tax room to provinces in respect of shared programs

In 1967, federal-provincial fiscal arrangements were altered. The federal government substituted a transfer of corporate income tax points for direct transfers to provinces under the cost-shared program for post-secondary education. The tax change involved an increase in the corporate income tax abatement rate from 9 to 10 percentage points, effectively reducing the federal corporate income tax rate at that time from 37 per cent to 36 per cent (the rate before the abatements was 46 per cent). This transfer of tax room has been included as a tax expenditure because it is a substitute for direct spending programs.

Interest credited to life insurance policies

Life insurance companies are taxed under the Investment Income Tax (IIT) at a rate of 15 per cent on net investment earnings attributable to life insurance policies.

The IIT interacts with the taxation of policyholders. The Income Tax Act divides life insurance policies into two categories: savings-oriented policies and protection-oriented policies.

Savings-oriented policies are those where the amount of money invested in the policy is large relative to the death benefit. A holder of a savings-oriented policy is subject to annual accrual taxation in respect of the net investment earnings credited to the policy. Net investment earnings reported by these holders are subtracted from the IIT tax base in order to avoid double taxation of net investment earnings.

In contrast, a holder of a protection-oriented policy is not subject to annual accrual taxation. Net investment earnings are taxed when the policy is surrendered or terminated (other than by death), or when paid out as policy dividends once the cumulative dividends exceed the total premiums paid under the policy. Net investment earnings that are taxable to holders of protection-oriented policies are also deductible from the IIT base.

Most of the cost of the tax expenditure relates to protection-oriented policies. This cost has three basic elements:

- differences between personal and IIT tax rates,
- timing differences (i.e. policies that are eventually taxed in the hands of policyholders), and
- permanent differences (i.e. policies that are held until the death of the insured).

The Excise Tax Transportation Rebate

The Excise Tax Transportation Rebate introduced in 1991 and effective for the 1991 and 1992 calendar years allowed transportation businesses to receive an excise tax rebate of 3 cents for each litre of eligible fuel on which federal fuel excise tax of 4 cents per litre was paid. In exchange, businesses who elected to received this rebate were required to reduce their income tax losses by $10 for every $1 rebated. This provided the industry with an immediate cash-flow benefit at the cost of lower loss carry-forwards to offset income taxes as conditions improve.

This rebate was applicable to purchases of diesel and aviation fuel subject to federal excise tax during the 1991 and 1992 calendar years.

A simpler option was available for trucking businesses who could elect to receive a rebate of 1½ cents per litre up to a maximum of $500 per taxpayer in lieu of the 3 cent per litre rebate.

Non-taxation of registered charities and other non-profit organizations

Registered charities and other non-profit organizations, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the charity or organization has income, mainly investment income or profits from certain commercial activities.

No data are available.

Income tax exemption for provincial and municipal corporations

Provincial Crown corporations and municipal corporations are exempt from income tax. Under the benchmark tax structure, such corporations would be taxable to the extent that they had taxable income.

No data are available.

Non-taxation of certain federal Crown corporations

While federal Crown corporations are generally not subject to income tax, those Crown corporations that carry on significant commercial activities are taxable. It is possible, however, that some exempt corporations have income that would be taxable under the benchmark tax system.

No data are available.

Memorandum Items

Excess of tax depreciation over depreciation for financial statement purposes

Issues in calculating the cash-flow impact of the excess of tax depreciation over depreciation for financial statement purposes

Under the benchmark tax system, corporations would be permitted a deduction for the use of capital equipment equal to the economic depreciation rate. Since economic depreciation rates are difficult to estimate for many categories of assets, a practical alternative is to adopt the depreciation rates used by the corporations in their financial statements. These rates are accessible and follow accounting norms that generally make them similar to economic depreciation rates. That is, they represent the taxpayers' own estimates of the useful lives of their assets.

In keeping with the cash-flow concept for valuing tax measures in this report, the tax value of CCA provisions has been estimated in reference to the depreciation as recorded in taxpayers' financial statements. That is, the value of the forgone revenue arising from the CCA is equal to the difference between CCA claims and depreciation for financial statement purposes multiplied by the corporation's marginal tax rate. The figures reported in the tables show the change in federal tax revenues that would result if corporations had claimed depreciation for financial statement purposes instead of CCA in computing income for tax purposes. As discussed below, when CCA differs from depreciation for financial statement purposes, some but not necessarily all of this may represent a tax expenditure. There may be other reasons why there is a difference between depreciation for financial statement purposes and CCA that are unrelated to the existence of a tax preference, which is why this measure is classified as a memorandum item. Furthermore, the available data do not permit a separation of the tax expenditure component associated with this provision from the portion that is essentially part of the benchmark system.

Differences between CCA and depreciation for financial statement purposes

CCA may differ in several fundamental ways from depreciation for financial statement purposes. First, the CCA rates at which assets can be written off against income may be faster than the rates used in companies' financial accounts. As a result of tax reform in 1988, however, the number of asset classes that have accelerated depreciation rates was reduced significantly. Where fast write-offs are still available, the CCA system allows a larger deduction from income for the first few years after the property is acquired. During these initial years, this treatment results in lower taxable income and thus lower tax liability than if depreciation for financial statement purposes had been claimed. For later taxation years, however, depreciation for financial statement purposes would be greater than that allowed for tax purposes.

Thus, income for tax purposes in these later years would be higher than if depreciation for financial statement purposes had been used. On balance, there has been a deferral of taxes. In the case of growing firms with many assets, the larger CCA claims on the newer assets would always be sufficient to offset the smaller CCA claims on older assets, so that taxable income would be continually lower than it otherwise would be. In this case, the tax deferral becomes indefinite and would be equivalent to a tax reduction.

Second, the CCA rate may be less than the depreciation rate for financial statement purposes. An example of this situation could be rapidly depreciating equipment where the CCA rate has not kept pace with changes in technology, which quickly render some equipment obsolete. During the initial years, CCA would be less than depreciation for financial statement purposes and there would be a prepayment of taxes. During the later years, CCA would exceed depreciation for financial statement purposes and there would be a tax savings. If this situation arises, the estimate of the cost of the tax expenditure would be negative.

As a result of the static nature of the calculation used in this study, the amount of the tax preference arising from accelerated or deficient CCA rates cannot be identified. The calculation is made at a particular point in time (the 1991 or 1992 taxation year) and not over the entire life of the asset. For example, consider the case of an asset where an accelerated CCA rate is provided. Clearly, a tax preference is available since there is a deferral of tax over the lifetime of the asset. If we look at the difference between CCA and depreciation for financial statement purposes during one of the initial years of the asset's life, we would generate a positive estimate, which is the correct conclusion, although the actual amount would be incorrect from a lifetime perspective. On the other hand, if we were to perform the same calculation at a later year (i.e. when depreciation for financial statement purposes exceeds CCA) we would obtain a negative estimate, which would be incorrect.

The third difference between CCA claimed and depreciation for financial statement purposes is that taxpayers have discretion in choosing the amount of CCA to deduct in a year, subject to a maximum amount. If taxpayers do not have sufficient taxable income, they need not claim the CCA available to them in that year; they can wait for a future year. By doing so, taxpayers can avoid creating a tax loss, which is subject to a limited carry-over period during which it can be deducted (i.e. three years back, seven years forward). On the other hand, there is no time limit on using CCA. Consequently, observing tax depreciation that exceeds depreciation for financial statement purposes does not necessarily imply that a tax preference has been provided. For example, consider an asset where the CCA rate and the depreciation rate for financial statement purposes are identical. If a taxpayer does not deduct CCA in one year and then makes the deduction in subsequent years, the amounts claimed for tax and depreciation for financial statement purposes would be different in these years even though there is no tax preference associated with this asset. Viewed in this light, the discretionary nature of the CCA deduction

may be seen as another mechanism to carry over losses to future years. If differences arise between CCA and depreciation for financial statement purposes for loss carry-over reasons, these should not be considered to be tax expenditures.

The fourth difference between CCA claimed and depreciation for financial statement purposes arises from the pooling of assets into CCA classes. (There are some exceptions such as rental buildings costing at least $50,000, which are placed in a separate prescribed class.) Depreciation for financial statement purposes is determined by reference to each individual asset. If an asset that originally cost $100 has depreciated so that its current book value is $50, and it is sold for $70, at least in principle the $20 difference would be brought into income. However, under the CCA system, this asset would typically be grouped with other assets in a CCA class and the proceeds of a sale would serve to reduce the total undepreciated capital cost of the class. Generally, the effect of this pooling is that the $20 of unrealized recapture on the disposal of property is gradually brought into income as future CCA claims for the class are reduced accordingly. Thus, the recapture of any "excess" depreciation claim may be deferred well beyond the time of disposition of an asset. Similarly, there may be a corresponding deferral in the recognition of terminal losses when the asset is sold for less than its depreciated value.

Finally, tax depreciation and depreciation for financial statement purposes differ in their treatment of interest payments related to the acquisition of a capital asset. For accounting purposes, interest payments may be capitalized in the cost of the asset; for tax purposes, interest payments are generally expensed in the year they are incurred.

Specific provisions

The CCA rate exceeds depreciation for financial statement purposes in some cases. The more generous provisions for certain types of property are described below. Except for capital equipment used in scientific research and experimental development, specific valuations of these special provisions could not be made under the cash-flow method as depreciation for financial statement purposes cannot be attributed to the various CCA classes.

Manufacturing and processing assets (class 29, 39, 40, 43)

Specified property used primarily in manufacturing and processing was depreciated over three years at a 25-per-cent, 50-per-cent, 25-per-cent straight-line rate in class 29, if acquired after November 12, 1981 and before 1988.

After 1987, most M&P machinery and equipment assets went into class 39, which has a depreciation rate that diminished in stages to a 25-per-cent rate calculated on a declining balance basis with a half-year rule. In 1990, the rate was 30 per cent, which declined to 25 per cent in 1991. Effective February 25, 1992, manufacturing and processing assets are included in class 43, which has a depreciation rate of 30 per cent.

Certain assets (primarily lift trucks and computers) acquired in the calendar year 1988 or 1989 were placed in class 40, where the CCA rate was 40 per cent in 1988 and 35 per cent in 1989. These assets acquired after calendar 1989 fall into class 10 at a 30-per-cent declining balance rate.

Vessels (class 7)

Vessels are generally included in class 7 and are subject to a maximum CCA rate of 15 per cent. Accelerated CCA on a straight line basis at a maximum rate of 33⅓ per cent of the capital cost of the property is available in respect of a vessel including furniture, fittings, radio communication equipment and other equipment if it was (a) constructed in Canada, (b) registered in Canada, and (c) not used for any purpose whatever before acquisition by the owner. For vessels acquired before July 14, 1990, this accelerated capital cost allowance was available only if the Minister of Industry, Trade and Commerce (now the Minister of Industry) certified that all the above conditions had been met. This certification requirement was withdrawn for acquisitions after July 13, 1990.

Offshore drilling vessels (class 7, 41)

Certain offshore drilling vessels qualify for an additional 15-per-cent CCA for an effective rate of 30 per cent, subject to the half-year rule. An offshore drilling vessel acquired after December 31, 1987 becomes a class 41 rather than a class 7 asset and is depreciated at 25 per cent.

Power-operated movable equipment (class 22, 38)

Such equipment designed for the purpose of excavating, moving, placing or compacting earth, rock, concrete or asphalt acquired after March 16, 1964 and before 1988 can be depreciated at a 50-per-cent CCA rate, subject to the half-year rule. Equipment acquired after 1988 is depreciated under class 38, at a 35-per-cent CCA rate in 1989 and 30 per cent after 1989.

Railway assets (class 35)

Railway cars acquired after May 25, 1976 qualify for class 35, which has a CCA rate of 7 per cent. Railway cars acquired on or before February 2, 1990 and not for rent or lease are eligible for an additional allowance of 8 per cent. The additional allowance is reduced to 6 per cent for cars acquired after February 2, 1990. Railway cars acquired before April 27, 1989 for rent or lease are eligible for an additional allowance of 8 per cent – diminished to 6 per cent over the 1990 to 1995 taxation years. The rate is reduced to 6 per cent for cars acquired after April 26, 1989. Railway cars acquired after December 6, 1991 by common carriers are eligible for an additional allowance of 3 per cent.

Communication satellites (class 30)

Unmanned telecommunication space craft acquired before 1988 can be written off on a 40-per-cent declining balance basis subject to the half-year rule.

Retailer's point-of-sale equipment (class 12)

A 100-per-cent CCA rate is applicable for certain types of point-of-sale equipment acquired after August 8, 1989 and before January 1, 1993. In addition, the half-year rule does not apply to these purchases. The equipment must be acquired for use in a business selling goods or providing services to consumers that is carried on in Canada or for lease to another taxpayer for use by that taxpayer in such a business.

Application software (class 12)

A 100-per-cent CCA rate, with the half-year rule, is applicable for application software or a right or license to use application software acquired after May 25, 1976.

Certified Canadian films (class 12, 10(w))

Certified productions acquired before 1988 qualify for a CCA rate of 100 per cent (class 12). Certified productions acquired after 1987 become class 10(w) property and are depreciated at a 30-per-cent declining balance rate, but are not subject to the half-year rule when acquired. An additional allowance up to the remaining undepreciated capital cost of the film property is deductible against income from Canadian films.

Energy-efficient equipment (class 34)

Straight-line depreciation of 25 per cent, 50 per cent and 25 per cent is applicable to certain equipment used for the generation of electricity or the production or distribution of heat. The equipment has to meet certain criteria relating to more efficient use of fuels or the utilization of waste materials to be eligible and be certified by the Minister of Natural Resources. Qualifying equipment includes equipment designed to: produce heat derived primarily from the consumption of wood wastes or municipal wastes; produce electrical energy by using wind energy; or recover heat that is a by-product of an industrial process. Also included as qualifying equipment are: hydro-electric installations not exceeding 15 megawatts; certain types of co-generation equipment; and certain types of active solar heating equipment.

(Changes to this class were announced in the 1994 budget. The changes effectively terminated new additions to class 34, redefined eligibility criteria, and reduced the depreciation rate to 30 per cent under class 43.1.)

Water and air pollution control property (class 24, 27)

Assets which are acquired primarily for the purposes of abating water or air pollution at a site qualify as class 24 or class 27. These assets are eligible for a straight-line allowance of 25 per cent, 50 per cent and 25 per cent over three years. This special allowance for water and air pollution control equipment is applicable only to new property that is used in operations that were started before 1974 and have been continuously carried on since that time. The eligibility of such property, once established, can flow through corporate amalgamations and wind-ups.

(Changes to this class were proposed in the 1994 budget that will sunset these two classes by 1999.)

Mining assets (class 28, 41)

Certain mining buildings, machinery and equipment acquired for use at a new mine or a major expansion of an existing mine may qualify for an accelerated CCA rate of up to 100 per cent. A 25-per-cent increase in a mine's capacity is generally considered to be a major expansion.

These mining assets were previously included in class 28, and depreciated at a 30-per-cent rate. For acquisitions after 1987, these assets are included in class 41, and depreciated at a 25-per-cent rate. In addition to the 25-per-cent allowance provided in class 41, a taxpayer owning such property and operating the mine may claim an addition allowance equal to the lesser of (1) the remaining undepreciated capital cost of property of the class, or (2) the income for the year from the new or expanded mine.

Fast write-off for Canadian development expense (CDE) and Canadian exploration expense (CEE)

The tax system provides deductions of a taxpayer's exploration and development expenditures through Canadian exploration expenses (CEE), Canadian development expenses (CDE), Canadian oil and gas property expenses (COGPE), and foreign exploration and development expenses (FEDE).

Intangible capital costs associated with developing an oil and gas property are classified as CDE and written off at a 30-per-cent declining balance rate. Pre-production development costs (such as the removal of overburden) incurred prior to the commencement of commercial production of a mine are CEE. Overburden removal and the construction of haulageways for mines that have commenced commercial production are classified as CDE. The costs of acquiring mineral properties are generally treated as CDE. Unused expenditures are accumulated in a separate account known as the cumulative Canadian development expenses (CCDE) account or pool. Any undeducted balances in the CCDE account can be carried forward indefinitely.

Expenditures incurred in determining the existence, location, extent or quality of mineral resources, and oil or gas, or incurred to develop mineral resources prior to commercial production in Canada are deducted for tax purposes at a rate of 100 per cent. These expenditures are recorded by the taxpayer in a separate account known as the cumulative Canadian exploration expense (CCEE) account and any undeducted balance may be deducted in future taxation years. There is no time limit on carrying forward these expenses.

For the taxation years under consideration, a principal business corporation (PBC) must deduct any balance in its CCEE account to the extent of its income for that taxation year and may not use this deduction to create a non-capital loss. This deduction is optional for a non-PBC or individual, and may be used by these taxpayers to create a non-capital loss.

(The December 1992 Economic and Fiscal Statement announced that mining and oil and gas companies will have more flexibility in utilizing non-capital losses before they expire by making the deduction of CEE elective, rather than mandatory, to the extent of the company's income for the year. This change is effective for taxation years ending after 1992.)

No estimates have been made of the tax expenditure costs for either FEDE or COGPE. The tax expenditure due to FEDE is relatively small. In the case of COGPE, the existing maximum deduction rate of 10 per cent is generally similar to the depreciation rate of the oil and gas property for financial statement purposes and so the current tax treatment does not give rise to a tax expenditure.

Differences between tax treatment and accounting treatment

Generally accepted accounting principles allow companies to depreciate exploration and development expenditures on either a "full cost" or a "successful efforts" basis. The full cost method requires that all costs, whether they result in new production or not, are capitalized and amortized as the reserves are depleted. The successful efforts method requires that only those costs which result in the discovery of reserves and which have a benefit in terms of future revenues are capitalized; other costs are expensed as incurred. Most Canadian-controlled companies follow the full cost method, while those in Canada that are foreign-controlled companies usually follow the successful efforts method.

The 30-per-cent declining balance rate for CDE may be in excess of the effective write-off rate. Whether or not the 30-per-cent rate is, in fact, accelerated depends on the life of the reserve being developed and on the rate of production of the reserve. For example, the 30-per-cent rate is accelerated in the case of those wells that have at least a 10-year life span.

The 100-per-cent write-off of CEE for tax purposes is more rapid than the amounts used for financial statement purposes which require the amortization of some of the expenditures. Thus, the fast write-off for CEE provides a deferral of tax.

Benchmark tax system

Under the benchmark tax system, corporations would be permitted an immediate deduction for unsuccessful exploration expenditures. However, those costs associated with successful exploratory activities (i.e. those costs that result in producing assets for both the mining and oil and gas sectors) would be permitted a deduction based on an amortization over the life of the asset. Similarly, development costs should be amortized over the life of the asset created by the expenditure. As noted in the previous section on depreciation, economic depreciation rates are difficult to estimate and a practical alternative would be to use the accounting treatment for such assets in financial statements.

Previous editions of this publication have identified CEE and CDE under the deferrals category of tax expenditures. The current publication combines the two items as a single tax expenditure and reclassifies the combined measure as a memorandum item to reflect the fact that the available data do not permit a separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. Due to this lack of data, the

estimates provided here do not include exploration and development write-offs for financial statement purposes in the benchmark in calculating the combined tax expenditure. Consequently, the estimate provided overstates the amount of any tax expenditure.

The estimation of any tax expenditure applies to a particular point in time (i.e. the 1991 or 1992 taxation year) and not over the entire life of the asset. The CDE and CEE write-offs allow a large deduction from income for the first few years after expenditures are incurred. During these initial years, this treatment results in lower taxable income and thus lower tax liability than if the corresponding deductions for financial statement purposes had been claimed. These deductions include depletion, exploration and development expenses (this latter item only for those companies following successful efforts accounting practices), and they represent an aggregate of intangible costs associated with exploration and development. For later taxation years, however, financial statement deductions would be greater than that allowed for tax purposes. Thus, income for tax purposes in these later years would be higher than if deductions for financial purposes had been used. On balance, it would appear that there has been a deferral of taxes arising from the CEE and CDE deductions. It should be noted however that, like depreciation, this is a static calculation.

Steps are being taken to collect the financial data necessary for the benchmark calculation so that future tax expenditure estimates for this item are more precise. An alternative set of estimates, which includes a benchmark comparison, has been calculated by Natural Resources Canada (NRCan) for the combined CDE and CEE tax expenditure for the oil and gas industry. The information on which this calculation is based was collected by the Petroleum Monitoring and Energy Statistics Division of NRCan. However, these data do not permit a tax expenditure estimate for CDE and CEE separately, and do not include the mining industry.

The NRCan approach takes into consideration the fact that a benchmark system would allow for some deductions in respect of exploration and development costs. For each company, the tax expenditure is derived by applying the corporate tax rate to the difference between the tax write-offs related to these costs and the corresponding accounting deductions. The results reflect the tax position of each company during the years in question. It should be noted that this approach is conceptually similar to the calculation of the excess of tax depreciation over depreciation for financial statement purposes discussed in this section. Using this approach, the tax expenditure estimates of the fast write-off for CDE and CEE in the oil and gas industry were $9 million in 1991 and $143 million in 1992. As a result of the economic downturn between 1991 and 1992, the industry shifted its activities away from more risky exploration and towards development. This had the result of lowering the proportion of unsuccessful spending, leading to a greater difference between tax and book write-offs, and thus a higher tax expenditure.

Finally, it should be noted that any estimates of the tax expenditures associated with CDE and CEE must be interpreted carefully. It is important to note that the ability of mining corporations and oil and gas corporations to flow out CEE, CDE and COGPE to investors through limited partnerships, joint exploration corporations or by issuing flow-through shares affects the allocation of the cost of the tax measure between personal and corporate income taxes and among industry sectors.

Deductibility of provincial royalties for the Syncrude project

Taxpaying participants in the Syncrude project are permitted to deduct both the resource allowance and provincial royalties (in this case, "joint venture" payments made to the province of Alberta in lieu of a royalty) in computing income subject to tax. This is accomplished through a remission order. Under the benchmark tax system, these taxpayers would be permitted to deduct only provincial royalties. The value of the tax expenditure is calculated as the value of the resource allowance deduction.

Deductibility of royalties paid to Indian bands

Royalties and lease rentals paid to Indian bands in respect of oil and gas and mining activities on Indian reservations are considered to be Crown charges paid to Her Majesty in Right of Canada or of a Province in trust to the Indian band. Unlike non-deductible Crown charges, amounts paid to the benefit of an Indian band are generally deductible for federal income tax purposes. In addition to the deductible Crown charges, a resource allowance is earned on the resource profits net of the deductible Crown charges.

In the benchmark tax system, the Crown charges would be deductible, but no resource allowance would be earned. Therefore, the cost of the tax expenditure is the value to the taxpayer of the resource allowance deduction.

There are no available data on the amount deducted. However, the amounts paid to the Government of Canada in the form of mining and oil and gas royalties/lease rentals paid to Indian bands are provided below:

Oil and gas and mining royalties/lease rentals paid to Indian bands

	1991-92	1992-93	1993-94	1994-95
		(millions of dollars)		
Oil and gas	53	50	59	76
Mining	1	0.8	0.2	0.7

Source: Accounting Operations Finance Branch, Indian and Northern Affairs Canada.

The following two items are parts of the tax system that provide some integration between the personal and corporate tax systems. Their values are calculated as additional corporate taxes that would be owing if corporations and individuals were treated as separate tax units.

Refundable Part I tax on investment income of private corporations

As a method of integrating personal and corporate income taxes, a portion of the income taxes paid on investment income received by a private corporation (excluding deductible inter-corporate dividends) is refunded to a CCPC when this income is paid out to shareholders as dividends.

(To further ensure the integration of corporate and individual income taxes, the 1995 federal budget announced the introduction of an additional refundable tax, to be levied after June 30, 1995, on the investment income received by a CCPC. This additional tax will also be refunded to a private corporation, along with refundable Part I tax, when the investment income is paid to shareholders as dividends.)

Refundable capital gains for special investment corporations

Capital gains realized by an investment corporation are taxed at the corporation level and the tax is accumulated in the "refundable capital gains tax on hand" account. The corporation uses this account to claim a capital gains refund when it distributes capital gains dividends to its shareholders. Since these dividends are capital gains distributions, they are taxed as capital gains in the hands of the shareholder and not as dividends.

Loss carry-overs

Loss carry-overs are part of the benchmark tax system because the cyclical nature of business income suggests that such income should be viewed over a number of years. The loss carry-over rules permit taxpayers to apply their losses against past or future income. Where available, the revenue estimates indicate how much revenue the government forgoes by allowing current year losses to be applied against income from past years.

Non-capital loss

A non-capital loss is a company's loss from business operations. Non-capital losses may be carried back three years and forward seven years to reduce or offset the corporation's taxable income.

Net capital loss

A net capital loss can arise from the disposition of capital property. This type of loss may be carried back three years and forward indefinitely but applied only against net capital gains that are taxable.

No data are available.

Farm losses and restricted farm losses

A taxpayer who operates a farming or fishing business can deduct, in the calculation of its net income, a loss incurred from its business operation. The unused losses of a given year may be carried back three years and forward ten years.

When the major source of income is not farming, the amount of losses deductible in the year is restricted to a maximum of $8,750 against other income. The unused losses, defined as the excess of the net farm losses over the farm losses deductible in the year are considered restricted farm losses. Restricted farm losses may also be carried back three years and forward ten years but only against farm income.

Data are not available to estimate the forgone revenue.

Meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

Until 1994, the deduction was limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment was part of a package price which included amounts not subject to the 80-per-cent limitation, for instance the fee for a conference, the taxpayer was required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation.

(The 1994 budget reduced the deductible portion of meals and entertainment expenses to 50 per cent.)

Large corporations tax

The large corporations tax (LCT) was introduced on July 1, 1989 as a tax on the Canadian capital of large corporations. The rate of tax in 1991 and 1992 was 0.2 per cent.

This tax ensures that all large corporations with more than $10 million of taxable capital employed in Canada pay some federal tax. Amounts paid under the large corporations tax (LCT) could be used to reduce the Canadian portion of the 3-per-cent corporate surtax.

(The 1995 budget proposed an increase in the LCT rate to 0.225 per cent.)

Threshold

The $10 million capital deduction effectively exempts smaller corporations from the LCT as long as these corporations are not related to other corporations subject to the LCT. That is, the $10 million deduction must be shared amongst related corporations. This capital deduction is not considered to be a tax expenditure because it is generally available to all corporations.

Exempt corporations

Certain corporations such as non-resident investment corporations, deposit insurance corporations and corporations exempt from paying Part I income tax are exempt from paying the LCT. This exemption is a tax expenditure, but data are not available to estimate its value.

Patronage dividend deduction by credit unions and co-operatives

Patronage dividends (the excess of revenues over costs) paid out by a credit union or a co-operative to its members are deductible in computing the corporate income tax liability of credit unions and co-operatives. The taxpayer is required to withhold 15 per cent of all patronage dividends in excess of $100 paid to each customer who is resident in Canada.

The appropriate benchmark tax treatment of patronage dividends is uncertain. These dividends could be considered to be analogous to the payment of a volume discount or the return of excess payments. With this view of the benchmark system, this would not be a tax expenditure.

Alternatively, these payments could be perceived as the distribution to members of earnings which would not be deductible under the benchmark system. The amount shown, reflecting this view of the benchmark system, is the revenue impact of allowing patronage dividends to be deductible from income.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of ⅔ of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province. The mandatory nature of the tax paid to the provinces leads to the classification of this provision as expenses incurred to earn income.

Non-resident-owned investment corporation refund

A non-resident-owned investment corporation must pay income tax at a rate of 25 per cent. However, except for capital gains realized on taxable Canadian property, this tax is refundable when the surplus is distributed as taxable dividends to the shareholders and the applicable rate of withholding tax then applies. The refund is designed to relieve the dividends paid to non-residents from double taxation that would otherwise result. The corporation is essentially treated as a conduit for the flow-through of income. The amounts reported estimate the tax revenues that would be generated if the non-resident-owned investment corporation refund was not available.

Investment corporation deduction

Investment income is taxed at the corporation level and in the hands of the individual who receives it as dividend payments. In order to achieve a certain degree of integration between the personal and corporate tax systems, the

current rules allow an investment corporation to deduct from its Part I tax otherwise payable 20 per cent of the amount by which its taxable income exceeds its taxed capital gains.

Deferral of capital gains income through various roll-over provisions

The taxation of capital gains is affected by provisions that permit taxpayers to defer realization for tax purposes through various roll-over provisions. Roll-overs associated with amalgamations and other corporate reorganizations have been considered part of the benchmark tax structure. Since the benchmark tax structure includes all accrued gains, this item is identified separately for information purposes. Examples include:

- the transfer of assets to a corporation or partnership in consideration for share capital or a partnership interest,
- amalgamations of taxable Canadian corporations,
- the winding-up of a subsidiary corporation into its parent corporation, and
- share-for-share exchanges.

(The 1994 budget proposed changes that will curtail the use of various roll-over provisions in certain reorganizations.)

No data are available.

Excess deduction for intangible assets

Three-quarters of eligible capital expenditures on intangible assets is added to cumulative eligible capital. A deduction of up to 7 per cent of cumulative eligible capital at the end of the year is allowed. An example of intangible assets is goodwill purchased upon the acquisition of a business.

This treatment of intangible assets could give rise to positive or negative estimates depending upon the actual rate of depreciation relative to the amount that is permitted for tax purposes.

No data are available.

Tax exemption on income of foreign affiliates of Canadian corporations

The Canadian system for taxing the income of foreign affiliates of Canadian shareholders or the dividend income of the Canadian shareholders derived from foreign affiliates is based on the objectives of encouraging international competitiveness, protecting the tax base and eliminating double taxation.

Where the foreign affiliate earns active business income, Canada defers any recognition of that income until it is paid to the Canadian shareholders as a dividend on shares of the affiliate. In cases where the business income has been earned in a country with which Canada has a double taxation treaty, the dividend paid out of that income to Canadian corporate shareholders is not

subject to additional Canadian tax. Where the business income is earned in non-treaty countries, the dividend is taxed in Canada but a tax deduction is provided to Canadian corporate shareholders based on the underlying foreign tax paid.

Where the foreign affiliate earns passive income and the affiliate is a controlled foreign affiliate of a person resident in Canada, the passive income is taxed in the Canadian shareholder's hands on an accrual basis. The Canadian shareholder can deduct taxes paid in the foreign jurisdiction in determining its net additional Canadian tax liability. When the income earned in the foreign affiliate is actually paid to the shareholder in the form of a dividend, a deduction from income subject to tax is provided to the extent that the income was included in income subject to tax in a previous year.

Questions arise as to what should be the appropriate benchmark system to measure the value of the tax expenditure, if any, in this case. Basically, three different benchmarks could be contemplated:

(a) Canada should tax only Canadian-source income. This is the territorial approach. Under this approach, foreign subsidiaries of Canadian companies would face the same tax burden on foreign-sourced business income as locally owned enterprises in the foreign jurisdiction. This approach is consistent with the concept of capital-import neutrality. Capital-import neutrality results when the shareholders of subsidiaries do not face additional taxes in Canada with respect to the foreign business income earned by their subsidiaries. This is the approach that Canada has adopted with respect to dividends arising from affiliates in countries with which Canada has entered into a double taxation agreement. If this exempt dividend approach were to be considered as the benchmark, then no preference would be associated with the foreign dividend exemption.

(b) Income earned by a foreign affiliate should be taxable in Canada when dividends are paid to the Canadian shareholder and double taxation alleviated with a foreign tax credit. This is the approach used by a number of countries since it allows for additional taxes to be collected in the country of residence of the shareholder of a foreign affiliate at the time a dividend is paid to the shareholder by the affiliate out of foreign business income. These additional taxes would be levied when domestic tax payable exceeds the amount of foreign taxes paid both on the dividend itself and on the underlying foreign corporate profits out of which the dividend was paid. In Canada, dividends from foreign affiliates that do not qualify as exempt dividends are taxed on this basis. If this were to be considered the benchmark system, then the exempt dividend system would provide a preference, measured as the additional tax, net of the foreign tax credit, that would have been payable had the dividend been taxable in Canada.

(c) Income earned by foreign affiliates should be taxable in Canada as it accrues to the Canadian shareholder, i.e. on a current basis. This system is consistent with the concept of capital-export neutrality, which states that

income of foreign affiliates should be subject to the same tax in the hands of its shareholders on a current basis regardless of whether the income is earned domestically or in a foreign affiliate. Certain passive income earned by controlled foreign affiliates is taxable on this basis in Canada. If this system were to be viewed as the benchmark, the foreign tax credit approach would be said to provide a preference measured as the deferral of incremental Canadian tax from the time the income is earned until the time the dividend is paid out.

Each of these three possible benchmarks has a policy justification. Data required to compute the amount of tax preference associated with any of the benchmarks are currently unavailable.

Categorization of Items by Industrial Category

To provide more information, an industrial breakdown of the major corporate tax measures has been included in the tables. Tax expenditures and their associated costs were redistributed across industries to reflect other information where available. The broad industry classifications are defined by the 1980 Standard Industrial Classification Code (SIC) and are indicated below:

Industry	Standard Industrial Classification Code
Agriculture, Forestry, and Fishing	0100 – 0599
Manufacturing	1000-3599, 3700 – 3999
Construction	4000 – 4499
Transportation and Storage	4500 – 4799
Communications	4800 – 4899
Public Utilities	4900 – 4999
Wholesale Trade	5000 – 5999
Retail Trade	6000 – 6999
Finance	7000 – 7699
Services	7700 – 7799, 8500 – 9999
Oil and Gas	0630 – 0799, 0910 – 0919, 3600 – 3699
Mining	0600 – 0629, 0800 – 0899, 0920 –0999
All Corporations	0000 – 9999

APPENDIX C
DESCRIPTION OF THE GOODS AND SERVICES TAX PROVISIONS

Since the Goods and Services Tax (GST) is levied at all points in the production and distribution chain, the value-added nature of the tax makes it equivalent to a retail sales tax levied on the sale of goods and services to the final consumer. Based on this equivalency, the GST base can be estimated using Statistics Canada's input-output tables and the National Accounts.

The input-output tables provide the data required to derive detailed expenditures by commodity for households, public sector bodies, and exempt businesses. The personal expenditure categories of the input-output tables along with the investment categories for residential construction and real estate commissions are used to derive commodity expenditures for households. The commodity expenditures of public sector bodies are derived from certain personal expenditure categories, current government expenditure categories and appropriate investment categories contained in the input-output tables. (Public sector bodies include the federal government, provincial governments, municipalities, universities, school boards, public colleges, hospitals, charities, and non-profit organizations.) The commodity expenditures of exempt businesses are derived from the input matrix of the input-output tables.

The commodity data described above are used to identify the impact of the GST provisions which either zero-rate or exempt certain goods and services. Since final input-output tables for a given year are available only four years after the fact, National Accounts data are used to project the impact of each GST provision to the relevant year.

It is not possible to use the National Accounts and the input-output tables to estimate the costs of all the tax expenditures associated with the GST. In some cases, modifications had to be made to the estimates derived from the input-output tables and the National Accounts. In other cases, actual data from Revenue Canada were used for the tax expenditure estimates, and certain estimates were derived from entirely different sources. This appendix describes the various GST tax expenditure estimates and how they were derived.

Zero-Rated Goods and Services

Basic groceries

Basic groceries, which include the majority of foodstuffs for preparation and consumption at home, are zero-rated under the GST. However, the tax is charged on certain goods such as soft drinks, candies and confections, and alcoholic beverages.

The cost of the tax expenditure can be estimated by using input-output data and the National Accounts to identify commodities purchased by final consumers and public sector bodies which are currently not subject to tax. The majority of these purchases are contained in the category “Food and Non-Alcoholic Beverages”.

Prescription drugs

Drugs that are controlled substances for which a prescription is required are zero-rated. This provision also includes other drugs that have been prescribed by a recognized health care practitioner. The associated dispensing fee is also zero-rated. However, this provision excludes those items labelled or supplied for veterinary use.

The estimate is derived from National Accounts and input-output tables. However, an adjustment is made to reflect the fact that the input-output commodity “Pharmaceuticals” includes both prescription and non-prescription medicine. The ratio used to separate these two categories of medicine is based on information provided by Health Canada.

Medical devices

A wide range of medical devices is zero-rated under the GST. Included in this provision are canes; crutches; wheelchairs; medical and surgical prostheses; ileostomy and colostomy devices; artificial breathing apparatus; hearing and speaking aids; prescription eyeglasses and contact lenses; various diabetic supplies; and, selected devices for the blind and for the hearing or speech impaired. In some instances, a device qualifies for tax-free status only if it is prescribed by a recognized health care practitioner.

The estimate is based on National Accounts and input-output tables. The zero-rated medical devices are found in the input-output commodities “Personal Medical Goods”, “Medical and Dental Equipment and Supplies”, and “Ophthalmic Goods”. It should be noted that all of the expenditures made by final consumers on these commodities are assumed to be zero-rated even though a small portion of these expenditures are, in fact, ineligible for tax relief. However, no adjustment is made to this estimate due to limited information.

Agricultural and fish products and purchases

Instead of taxing sales and providing input tax credits at early stages in the food production-distribution chain, this provision zero-rates certain agricultural and fish products all through the chain. A prescribed list of such supplies includes farm livestock, poultry, bees, grains and seeds for planting or feed, hops, barley, flax seed, straw, sugar cane or beets, etc. In addition, prescribed sales and purchases of major types of agricultural and fishing equipment are zero-rated.

The main effect of this provision is on the cash-flow position of taxpayers. For example, in the normal operation of the GST, farmers would pay the GST on taxable purchases and would claim a corresponding input tax credit at the

end of their tax period. However, in the case of prescribed zero-rated supplies, the farmer does not pay the GST and so does not have to wait to claim an input tax credit. Consequently, the cash-flow position of the farmer is improved. At the same time, however, the suppliers lose the benefit of holding the GST on these purchases until the end of their tax period. Since the aggregate tax liability of these taxpayers remains unchanged, the revenue implications of this measure are small.

Certain zero-rated purchases made by exporters

This provision zero-rates certain supplies of goods and services delivered in Canada but subsequently exported. These include:

- the supply of a good to a recipient who intends to export the property, provided it is not an exciseable good (spirits, beer or tobacco) and the good is not further processed or modified in Canada by the recipient;
- a supply of an exciseable good to a recipient who, in turn, exports the goods in bond;
- a supply of natural gas made to a person who is exporting the gas by pipeline and not further processing or using the gas in Canada before its exportation other than as fuel or compressor gas to transport the gas; and
- goods sold to duty free shops licensed as such under the Customs Act.

As with agricultural and fish products, this provision has only cash-flow implications. Again, the impact of this measure on tax revenues is small.

Non-taxable importations

Certain importations are tax-free under the GST. These importations include goods, other than books and periodicals, valued at not more than $20 and mailed to residents of Canada from other countries. This provision also applies to duty-free personal importations such as goods valued at not more than $300 and imported by Canadians who have been outside the country for more than seven days (the limit was increased to $500 on June 13, 1995), as well as goods imported by foreign diplomats.

No data are available.

Tax Exempt Goods and Services

Long-term residential rent

Rentals of a residential complex (such as a house) or a residential unit (such as an apartment) for a period of at least a month are tax exempt. Short-term accommodation is also exempt where the charge for the accommodation is not more than $20 per day.

The estimate is based on the GST being applied on the commodity "cash rent" contained in the input-output tables, and incorporates the loss of the GST currently paid on business inputs purchased by the landlord.

Health care services

Health care services are exempt under the GST. These services include the following categories:

- **Institutional health care services provided in a health care facility.** These include accommodation, meals provided with accommodation, and rentals of medical equipment to patients or residents of the facility. However, it excludes meals served in a cafeteria, parking charges, or haircuts for which a separate fee is charged.
- **Services provided by certain health care practitioners who must be licensed or otherwise certified to practise the particular profession in provinces.** This category includes services such as dental, optometric, chiropractic, physiotherapy, chiropodic, podiatric, osteopathic, audiological, and psychological services. It also includes speech therapy and occupational therapy.
- **Services covered by a provincial health insurance plan.** Most of these services are already covered by the previous two provisions.

All those exempt services which are covered by provincial health insurance plans are included in the benchmark because, Constitutionally, the GST cannot apply to purchases made by provincial governments. Thus, the only cost from this provision involves health services purchased by final consumers. The estimates for this provision are based on National Accounts and input-output data.

Education services (tuition)

The GST provides an exemption for most educational services. The exemption includes tuition fees paid for courses provided primarily for elementary or secondary school students; courses leading to credits towards a diploma or degree awarded by a recognized school authority, university or college; and certain other types of training for a trade or vocation. In addition, the exemption covers meals supplied to elementary or secondary students as well as most meal plans at a university or public college.

The estimate is derived from the revenues that would be collected if tuition fees were taxed and input tax credits were allowed for taxable purchases. The estimate takes into account the fact that universities and public colleges currently receive a rebate of 67 per cent of the tax that they pay on their purchases.

The estimate is based on the input-output commodity "Education Services" as well as data contained in Statistics Canada's publication "University Finance Trend Analysis".

Child care and personal services

Certain child and personal care services are exempt under the GST. The exemption covers the following:

- child care services provided for periods of less than 24 hours to children under 14 years of age;
- certain personal care services including supplies of care and supervision to residents of an institution, as well as accommodation where it is provided for children or disabled or underprivileged persons.

The estimate is derived from the input-output commodity "Personal Services, Including Child Care" contained in the final demand category "Domestic and Child Care Services". The estimate reported here is understated because it does not account for day care which might be paid by the government, or day care provided by a non-profit organization that could be eligible for a GST rebate.

Legal aid services

Legal services provided under a provincially authorized legal aid program are exempt under the GST. This includes payments by the client in respect of the legal aid services and payments by a legal aid society to a private lawyer for legal services.

There are two ways in which the tax is relieved:

- legal aid services delivered directly by the Crown or a Crown agency (as is the case in Nova Scotia, Newfoundland, Prince Edward Island, Manitoba, and Saskatchewan) are exempt;
- legal aid provided by private practitioners to a legal aid plan administrator are taxable. However, the person responsible for the legal aid plan is entitled to a rebate of 100 per cent of any tax paid on the supply.

Revenue Canada supplied the data related to the rebates provided to legal aid plans in the provinces of New Brunswick, Quebec, Ontario, Alberta and British Columbia. To account for the other provinces where the service is explicitly exempt, provincial economic accounts data are used. Specifically, it is assumed that the value of legal aid services relative to the total expenditures contained in the provincial economic account category "Personal Business" in the tax-exempt provinces would be the same as in those provinces where a rebate is provided.

Ferry, road and bridge tolls

International ferry services are treated as zero-rated like other international transportation services. Other ferry, road and bridge tolls are exempt under the GST.

The estimate is derived from the input-output tables based on the expenditures of final consumers on the commodity "Highway and Bridge Maintenance".

Municipal transit

Municipal transit service is defined as a public passenger transportation service provided by a transit authority whose services are at least 90 per cent within a particular municipality and its surrounding areas. These municipal transit services are exempt under the GST.

The estimate is based on National Accounts and input-output tables.

Exemption for small businesses

Businesses or individuals with annual sales of $30,000 or less from taxable and zero-rated transactions may elect to be exempt under the GST. Such firms would not have to charge tax on their sales and would not be able to claim input tax credits on their business purchases.

The estimate is based on gross sales contained in the personal and corporate income tax models. From this data, one can estimate that the total sales from firms with annual sales of less than $30,000 accounts for approximately 0.5 per cent of all sales in the Canadian economy. This ratio can then be applied to the total gross GST collections to approximate the revenues which would arise from eliminating the small business threshold.

Quick method accounting

Small businesses registered under the GST are eligible to elect to account for GST using Quick Method Accounting. Under the scheme, businesses do not have to keep track of the tax paid on most of their inputs. Instead, these firms remit a prescribed percentage of the GST which they collect on their sales. The remaining GST collected is kept by the firm in lieu of the unaccounted input tax credits. The firm is eligible to claim an input tax credit for the tax paid on capital goods.

The estimate is derived from micro-statistical data for 1991 supplied by Statistics Canada. The take-up rate of this provision for eligible small businesses is about 22 per cent. The estimate for subsequent years is derived by projecting the 1991 estimate based on information regarding the growth in total input tax credits claimed which is obtained from Revenue Canada.

Water and basic garbage collection services

Charges levied for water and basic garbage collection services are captured in the commodity "Water, Waste Disposal and Other Utilities" contained in the input-output tables. The estimate is based on expenditures on this commodity in the input-output tables and National Accounts data.

Domestic financial services

Financial services are defined to include services relating to financial intermediation, market intermediation and risk pooling. However, in many cases, the price of a financial service is implicit. For example, when banks

provide lending and deposit-taking services, the bank's fee for these services is the spread between interest rates received from borrowers and the interest paid to depositors. The exact price associated with each financial transaction is difficult to determine and, therefore, it is difficult to apply the GST to the sale of the service. As a result, most financial services provided to residents of Canada are exempt under the GST.

The GST also permits corporations to elect to be treated as "closely related" if there is at least 90 per cent common ownership. The purpose of this provision is to allow for grouping only in those situations where the members of the group operate, for all intents and purposes, like a single company. As a result, members of a closely related group which contains a listed financial institution may make an election that deems supplies of services and property made between them to be exempt financial services.

Data are not available.

Exempt supplies made by non-profit organizations

The exempt goods and services supplied by non-profit organizations include recreational services provided primarily to children aged 14 and under; recreational services provided to the underprivileged or disabled; supplies of food, beverage and lodging to relieve poverty or distress of individuals; and certain amateur performances.

No data are available.

Tax Rebates

Rebates for municipalities

Recognized municipalities are entitled to a rebate of 57.14 per cent of the GST paid on their purchases used in the course of supplying exempt municipal services.

The estimate is based on data from Revenue Canada.

Rebates for hospitals

Public hospitals are eligible for a rebate of 83 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for schools

Elementary and secondary schools, operating on a not-for-profit basis, are eligible for a rebate of 68 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for universities

Universities which are recognized degree-granting institutions operating on a not-for-profit basis are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for colleges

Public colleges which are funded by a government or municipality and whose primary purpose is to provide vocational, technical or general education are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for charities

Charities registered under the Income Tax Act are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for non-profit organizations

The organizations eligible for this rebate are government-funded non-profit organizations. They include registered amateur athletic associations and organizations operating a facility or part thereof to provide nursing home intermediate care or residential care, which receive at least 40 per cent of their funding from governments, municipalities or Indian bands. These organizations are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Housing rebate

Purchasers of newly constructed residential dwellings and substantially renovated houses are eligible for a rebate of the GST paid if the purchaser is acquiring the dwelling as a primary place of residence. For houses priced at or below $350,000, the rebate is 36 per cent of the total GST paid to a maximum of $8,750. The rebate is phased out for houses priced between $350,000 and $450,000.

The estimate is derived from the data on the value of residential housing contained in the National Accounts as well as the detailed newly constructed housing data contained in the Starts and Completions Survey conducted by Canada Mortgage and Housing Corporation.

Rebate to foreign visitors on accommodation

Non-residents visiting Canada are entitled to a rebate for the GST paid on most goods and short-term accommodation. Specifically, the rebate covers:

- goods for use primarily outside Canada, excluding exciseable goods such as alcoholic beverages and tobacco products, provided the goods are exported within 60 days of purchase;
- the tax paid on short-term lodging, but not including meals, where the period of stay is less than one month;
- the total tax paid must be at least $20.

However, goods for use outside Canada are essentially the same as other exported goods and should be considered as part of the benchmark. Thus, the cost of to this provision is only the rebate associated with short-term accommodation.

The estimate is based on data from Revenue Canada.

Special credit for certified institutions

A special credit is provided in the period from January 1, 1991 to the end of 1995 to certified institutions which employ mentally or physically disabled individuals in the manufacturing of goods. These institutions are treated in the same manner as other businesses under the GST. However, they receive a special credit calculated on the basis of 100 per cent of the GST collected from sales on manufactured goods in 1991, 75 per cent in 1992, 50 per cent in 1993 and 25 per cent in both 1994 and 1995.

No data are available.

The GST credit

As part of the introduction of the GST, a GST Credit was established to ensure that families with annual incomes below $30,000 would be better off under the new sales tax regime. The amount of the GST Credit depends upon family size and income. In 1992 and 1993, the basic adult credit was $199. Families with children 18 years and younger received a basic child credit of $105 for each child. However, single parents could claim a full adult credit of $199 for one dependent child. In addition to their basic credit, single adults (including single parents) were eligible for an additional credit of up to $105. The value of the credit was reduced for families with incomes of over $25,921. Both the credit amounts and the income threshold are adjusted annually to increases in the consumer price index in excess of 3 per cent.

The estimate is based on data from Revenue Canada.

Memorandum Items

Meals and entertainment expenses

In the normal operation of the GST, registrants are allowed to claim full input tax credits for the tax paid on their purchases. However, in the case of the tax paid on meals, beverages and entertainment expenses, the registrant is allowed to recover only 80 per cent of the GST paid as an input tax credit. There is no input tax credit allowed for the GST paid on membership fees or dues in any club whose main purpose is to provide dining, recreational or sporting facilities.

(The 1994 budget proposed that the input tax credit for business meals and expenses be reduced from 80 per cent to 50 per cent for purchases made after February 1994.)

The estimate is based on the cost of the meals and entertainment tax expenditures contained in the Personal and Corporate Income Tax Expenditure tables. These figures are first grossed up to arrive at the total meals and entertainment expenses in the entire economy using the marginal federal income tax rates by sectors. Then, 15 per cent is removed to account for expenses incurred in GST-exempt activities since they are ineligible for any input tax credits. The cost of this provision is equal to the above net expenses multiplied by 7 per cent.

Rebate to employees and partners

A rebate is available to certain employees of a GST registrant for the GST paid on those expenses that are deductible in computing the employee's income from employment for income tax purposes. For example, the employee is allowed to claim a rebate equal to 7/107ths of the capital cost allowance on an automobile, aircraft or musical instrument that is used in his or her employment and on which GST is payable. Also, the GST rebate is available to an individual who is a member of a GST-registered partnership in respect of expenses incurred outside the partnership that are deducted in computing the member's income from the partnership for the purposes of the Income Tax Act.

The estimate is based on data from Revenue Canada.

Sales of personal-use real property

The sale of personal-use real property by an individual or a trust (all the beneficiaries of which are individuals) is exempt under the GST. Examples include the sale of used owner-occupied homes and country properties kept for personal use. However, the exemption does not include real property that is sold in the course of a business.

No data are available.

Appendix D
Recent Changes to Personal Income Tax Expenditures

Transitional measures phased out in 1994

- For the 1989 to 1994 taxation years, married taxpayers were able to transfer up to $6,000 annually of their periodic pension payments from registered pension plans or deferred profit sharing plans to their spouse's RRSP.
- Residents of communities no longer eligible for the Northern Residents Deductions following the reform of northern benefits were eligible for transitional benefits until 1994.

Measures announced in 1994 budget

- Eliminate the $100,000 Lifetime Capital Gains Exemption.
- Eliminate exemption for the first $25,000 of coverage under employer-paid life insurance.
- Phase out the age credit for high income seniors.
- Reduce from $250 to $200 the threshold for the higher tax credit on charitable donations.
- Continue homebuyers' plan for first-time homebuyers only.

Measures announced in 1995 budget

- Exempt donations of ecologically sensitive land from the 20-per-cent limit.
- Reduce the contribution limits for Registered Retirement Savings Plans (RRSPs) and money-purchase Registered Pension Plans (RPPs) to $13,500. Reduce the allowable RRSP over-contribution from $8,000 to $2,000, and eliminate the tax-free rollover of retirement allowances to RRSPs for service after 1995.
- Require non-resident recipients of Old Age Security (OAS) benefits to report their world income for purposes of the OAS high-income clawback.
- Reinstate the 21-year rule for accrued capital gains on property held by trusts.
- Eliminate the preferred beneficiary election for most beneficiaries.

Measures included in the 1995 Technical Bill

- Eliminate double claims of personal credits in year of personal bankruptcy.
- Expand taxation of non-residents' gains on Canadian capital property.

Measures announced in 1996 budget

- Cease the inclusion of child support payments in the recipient's income, and disallow the deduction of these amounts by the payer, effective May 1, 1997.
- Increase to $750 the maximum Working Income Supplement (WIS), beginning on July 1, 1997. The maximum WIS benefit will increase again, reaching $1,000 on July 1, 1998.
- Increase from 14 to 16 the age limit for eligible children with respect to the child care expense deduction. Allow single parents attending school full-time to claim the child care expense deduction against all types of income, and recognize full-time attendance at secondary school for the purpose of this deduction.
- Increase the education amount available to full-time students from $80 to $100 per month.
- Increase from $4,000 to $5,000 the limit on the transfer of tuition fees and the education amount to a supporting spouse, parent or grandparent.
- Increase the annual and lifetime limits on contributions to Registered Education Savings Plans (RESPs), beginning in 1996.
- Increase the credit for infirm dependants, as well as the income threshold at which phase out of the credit begins.
- Reduce the tax credit in respect of Labour-Sponsored Venture Capital Corporations (LSVCCs), as well as the maximum purchase eligible for the credit. Increase the minimum-holding period with respect to the credit. Deny eligibility for the credit for three years following the redemption of an LSVCC share.
- Allow unlimited carry-forward of unused RRSP room.
- Freeze annual contribution limits for RRSPs and money-purchase RPPs until 2003, and freeze annual benefit limits for defined benefit pension plans until 2005.
- Reduce to 69 the age limit for contribution to RRSPs, RPPs and Deferred Profit Sharing Plans (DPSPs).
- Eliminate the administrative fee deduction for Registered Retirement Income Funds (RRIFs) and RRSPs.
- Limit the withholding tax relief available to non-resident recipients of Canadian pension income.
- Increase the annual limits on charitable donations.
- Propose to replace OAS and GIS with a new Seniors Benefit commencing in 2001.

RECENT CHANGES TO CORPORATE INCOME TAX EXPENDITURES

Measures announced or effective in 1993

- Lower the tax rate for manufacturing and processing – one percentage point reduction in the tax rate from 23 per cent to 22 per cent.
- Extend enhanced rate of SR&ED tax credit to small businesses with taxable income between $200,000 and $400,000.
- Eliminate annual limit on claiming investment tax credits.
- Separate class election for certain computer equipment, software, and office equipment.
- Patents may be placed in a new CCA class and be eligible for a 25-per-cent write-off rate.
- Exempt arm's length payments in respect of rights to use patented information concerning scientific experience from the non-resident withholding tax.
- Affirm commitment to exempt computer software from non-resident withholding tax.

Measures announced or effective in 1994

- Introduce a temporary 40-per-cent surcharge on tobacco manufacturing profits.
- Lower tax rate for manufacturing and processing – one percentage point reduction in the tax rate from 22 per cent to 21 per cent.
- Reduce from 80 per cent to 50 per cent the deduction for business meals and entertainment expenses to account for the personal consumption element of the expenses.
- Phase out access to the small business deduction for those larger private corporations having taxable capital between $10 and $15 million.
- Phase out access to refundable scientific research and experimental development (SR&ED) tax credits for those larger private corporations having taxable capital between $10 and $15 million.
- Require financial institutions and investment dealers to recognize accrued gains and losses on certain securities annually on a mark to market basis.
- Eliminate the 30-per-cent Special Investment Tax Credit and the 30-per-cent Atlantic SR&ED credit.
- Reduce the Atlantic Canada Investment Tax Credit from 15 per cent to 10 per cent.

- Eliminate the accelerated depreciation for air and water pollution abatement equipment effective 1999.
- Reduce the accelerated depreciation rate for energy conservation equipment from 50 per cent straight-line to 30 per cent declining balance.
- Tighten the rules applicable to foreign affiliates.
- Tighten the rules applicable on forgiveness of debt.
- Eliminate the use of "purchase butterflies" as a method to avoid tax on dispositions of appreciated corporate property.
- Increase the refundable tax on dividends received by private corporations (Part IV tax).
- Eliminate the special preference for sole-purpose SR&ED performers.
- Constrain certain tax shelter schemes that had been developed utilizing convertible debt and negative adjusted cost bases.
- Limit SR&ED tax credits to expenditures identified within 180 days following the year in which the expenditures are incurred.
- Require property and casualty insurers to fully discount unpaid claims.

Measures announced or effective in 1995

- Replace film tax shelter mechanism with an investment tax credit.
- Eliminate the deferral of business income using off-calendar fiscal periods.
- Tighten the rules relating to non-arm's length contract SR&ED, non-arm's length provision of goods and services for SR&ED and certain third-party payments.
- Subject to the findings of the review of information technology SR&ED, place an immediate "moratorium" on the claims for information technology SR&ED undertaken by financial institutions.
- Increase the large corporations tax rate from 0.2 per cent to 0.225 per cent and the corporate surtax rate from 3 per cent to 4 per cent.
- Introduce an additional tax on investment income of private corporations.
- Introduce a temporary 12-per-cent capital tax surtax on large deposit-taking institutions.

Measures announced or effective in 1996

- Tighten the resource allowance rules to provide a more consistent and stable resource allowance calculation and eliminate uncertainties related to court decisions.

- Tighten flow-through shares (FTS) to better focus the incentive – ensure that FTS are used to finance the more risky expenditures, such as exploration and development costs and not property-related costs.
- Reduce the threshold levels and introduced a new restriction on reclassifications of expenses by oil and gas companies using FTS to better target this incentive to junior companies in start-up situations.
- Exclude off-the-shelf seismic costs as eligible costs for FTS.
- Modify rules for accelerated CCA for mining activities – companies can earn accelerated CCA when they undertake large capital expenditures (i.e. above 5 per cent of gross revenues). In addition, oil sands projects using in situ extraction processes will also be eligible for accelerated allowances.
- Enhance incentives to invest in renewable energy – relaxing the specified energy property rules and expanding eligibility for flow-through shares.
- Extend the capital tax surcharge on large deposit-taking institutions by one year.
- Announce pending changes to the taxation of life insurance companies and a three-year extension of additional capital tax in life insurance, to take effect in 1996.
- Limit amount of wages and salaries eligible for SR&ED tax credits for specified employees.
- Terminate transitional provision for certain building rental payments in respect of SR&ED.
- Removed moratorium on claims for information technology SR&ED undertaken by financial institutions.

Recent Changes to GST Expenditures

The government has introduced over 100 measures to streamline and simplify the operation of Canada's sales tax. Many of the proposed legislative changes were developed in response to concerns raised by businesses, charities, non-profit organizations and other organizations during consultations over the last two years. The measures can be categorized as follows:

- measures to simplify the operation of the tax for many businesses, charities and non-profit organizations;
- measures to improve the fairness of the Goods and Services Tax for businesses and consumers; and
- clarifications and measures to ease compliance.

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Chapter 1
Framework and Methodology

Introduction

The purpose of this report is to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada's federal income tax system and the goods and services tax (GST). It is also an important input into the process of evaluating the operation of these tax systems. However, it should be emphasized that this report itself does not attempt to make judgements about either the appropriateness of government policy objectives or the effectiveness of the various tax provisions in achieving those objectives.

The principal function of taxes is to raise the revenues necessary to finance government operations. This tax revenue is often raised in a way which, at the same time, implements government policy objectives by providing assistance or incentives to particular groups of individuals, businesses or to certain types of activities. These measures, which can take the form of tax exemptions, deductions, rebates, deferrals or credits, are typically referred to as tax expenditures. This document provides historical estimates, based on a sample of taxpayer returns, of the cost of these items for the last years for which data are available. In the case of the personal income tax system, these are 1992, 1993 and 1994. For the corporate income tax system, they are 1992 and 1993. The GST estimates are for the years 1992 to 1995. In addition, for the first time, it also provides projections of these tax expenditures, beyond the last historical year, to 1999.

In order to identify tax expenditures, it is necessary to establish a "benchmark" tax structure which does not contain any preferential tax provisions. Tax expenditures are then defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the definition of the benchmark tax system, and hence what constitutes a tax expenditure. For example, child care expenses could be considered to be a cost of earning income and therefore part of the benchmark tax system; if not, then tax assistance for child care expenses would be a tax expenditure.

This report takes a broad approach – only the most fundamental structural elements of each tax system are considered to be part of the benchmark. By defining the benchmark in this manner, many tax provisions are treated as tax expenditures. This approach provides information on a full range of measures, and so allows readers who take a different position as to the appropriate benchmark system to construct their own list of tax expenditures.

In keeping with this objective of providing as much information as possible, the document identifies several tax provisions that are not generally considered to be tax expenditures even though they reduce the amount of revenue collected. These measures are denoted as “memorandum items” and have been included simply to provide additional information. Three types of memorandum item are included.

- Measures that are considered to be part of the benchmark system. The dividend tax credit, for example, reduces or eliminates the double taxation of income earned by corporations and distributed to individuals through dividends.
- Measures where there may be some debate over whether the item should be considered to be a tax expenditure. The cost of business-related meals and entertainment, for example, may be considered to be an expense incurred in order to earn income (and therefore part of the benchmark) or may be considered to provide a benefit (and therefore constitute a tax expenditure).
- Measures where the available data do not permit separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. For example, a portion of tax-free allowances for MPs is used to cover legitimate employment expenses (and is therefore part of the benchmark for the income tax system) while the rest may be used for personal consumption (and is therefore an income tax expenditure). Since it is not possible to distinguish between these two elements, the non-taxation of such allowances is included as a memorandum item.

The federal and provincial income tax and sales tax systems interact with each other to various degrees. As a result, changes to tax expenditures in the federal system may have consequences for provincial tax revenues. In this publication, however, any such provincial effects are ignored – that is, the tax expenditure estimates are purely federal in nature.

The remainder of this Chapter discusses the tax expenditure concept in order to facilitate understanding of the quantitative estimates. It also discusses the calculation and interpretation of the costs of tax expenditures, including key assumptions used in the analysis. Chapter 2 presents estimates of the costs of tax expenditures and memorandum items in the personal and corporate income tax systems and the GST.

Simplified descriptions of each tax expenditure as well as information on data sources and methodology used in constructing the estimates are presented in Chapter 3 (personal income tax), Chapter 4 (corporate income tax) and Chapter 5 (GST).

What are tax expenditures?

Tax expenditures represent an alternative to direct spending for achieving government policy objectives. They are defined as deviations from a benchmark tax system. Typically, they take the form of exemptions, deductions, rate reductions, rebates, credits or deferrals that are available to targeted groups of individuals or businesses.

In order to provide as much information as possible, a broad definition of the benchmark tax system has been adopted.

Given the informational intent of this report, estimates are also provided for some tax measures, such as the dividend tax credit, even though they are usually considered to be part of the benchmark tax system. These tax measures are referred to as memorandum items.

Elements of Tax Expenditures in the Personal and Corporate Income Tax Systems

The benchmark for the personal and corporate tax systems includes the existing tax rates and brackets, unit of taxation, time frame of taxation, treatment of inflation for calculating income and those measures designed to reduce or eliminate double taxation.

The definition of income is crucial in determining what is a tax expenditure. Tax provisions which provide for the deduction of current costs incurred to earn income are considered to be part of the benchmark system and therefore not tax expenditures. For example, the deductibility of labour costs or economic depreciation of business assets in determining business income would not be considered a tax expenditure.

It is important to emphasize that the definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. Reasonable differences of opinion may exist as to the interpretation and categorization of tax measures. For example, employment insurance (EI) premiums paid by an employee could be viewed either as an expense of earning income or as a tax used to finance an income transfer to the unemployed. From the first perspective, the current system of providing employees with a tax credit for contributions would not be a tax expenditure. The credit for EI premiums merely recognizes an expense of earning income, and hence, is part of the benchmark tax structure. On the other hand, one could argue that the tax credit for EI contributions represents a tax expenditure because the taxes paid by taxfilers are generally not deductible against personal income taxes. For this reason, the tax treatment of EI premiums is reported as a memorandum item. Measures such as these which are subject to debate are discussed on an individual basis in Chapters 3 and 4.

The following provides a more detailed discussion of the features of the benchmark for both the personal and corporate tax systems.

(1) Tax rates and income brackets

For the personal income tax system, the existing rate structure, including surtaxes, is taken to be part of the benchmark system. The basic personal credit is also treated as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax up to an initial level of income. However, the cost of this credit is included as a memorandum item.

With respect to the corporate income tax system, effective after February 27, 1995, the basic federal corporate tax rate is 29.12 per cent including the surtax but after the provincial abatement. Provisions that reduce this tax rate for certain types of activities or corporations are regarded as tax expenditures. These include the lower tax rate for manufacturing and processing profits, and the lower tax rate for small business profits, which is available on the first $200,000 of active business income earned by most Canadian-controlled private corporations (CCPCs). The large corporations tax, levied at the existing rate, is also considered to be part of the benchmark tax system.

(2) Tax unit

Personal income taxes in Canada are based on individual income. Consequently, the individual is taken as the benchmark tax unit for the purposes of identifying tax expenditures in this report. This choice leads to the classification of the various provisions related to dependants, such as the married credit, as tax expenditures.

The choice of the appropriate unit for the corporate income tax benchmark system raises a number of conceptual issues. There is a wide range of possible tax units, including the establishment or activity unit within a corporation, the single legal corporate entity, and the consolidated group of related corporations. The present income tax system contains elements of all these approaches. For example, the view that the activity unit is the appropriate unit of taxation is consistent with the “at-risk” rules, which restrict the amount of investment tax credits and business losses that may be flowed out to limited partners. The view that the single legal corporate entity is the relevant tax unit is supported by the fact that income from one part of a business can be offset by other business losses within the same corporation, whereas losses by one corporation may not generally be used against the income of another corporation in the group. Other provisions in the current tax system allow corporate groups to reorganize their corporate structures without triggering any capital gains or recaptured depreciation. These roll-over provisions lead to a deferral of capital gains and recaptured depreciation, which would be appropriate if the taxation unit is the consolidated group of related corporations. On balance, the view most closely related to the existing system is that of the single legal corporate entity. For this reason, the single

corporation is adopted as the benchmark tax unit, together with the availability of various roll-over provisions which permit the deferral of capital gains when a corporate structure is changed.

(3) Taxation period

The benchmark taxation period for the personal income tax system in this document is the calendar year. Accordingly, any measures which provide deferrals of taxable income to a subsequent year are considered to be tax expenditures. For example, farmers are permitted to defer the receipt of income from the sale of grain through the use of special cash purchase tickets and this is listed as a tax expenditure.

The benchmark taxation period for the corporate income tax system is the fiscal year. As with the personal tax system, deferrals, such as the accelerated write-off of capital assets, are considered to be tax expenditures.

A strict application of the annual taxation period would imply that measures which provide for the carry-over of losses to other years would be tax expenditures. However, the relatively cyclical nature of business and investment income suggests that such income should be viewed over a number of years. Consequently, carry-overs of business and investment losses are treated as part of the benchmark tax system in this report. Estimates of the cost of these provisions are provided in the memorandum items section.

(4) Treatment of inflation

Both the personal and corporate income tax systems are based on nominal income with a number of provisions that account for the impact of inflation. Nominal income is therefore taken as the appropriate basis for the benchmark tax system. Consequently, special measures, such as the partial exclusion of capital gains from taxable income, which may serve to recognize inflation, are identified as tax expenditures.

(5) Avoidance of double taxation

Conceptual difficulties arise in deciding whether certain provisions which reduce or eliminate double taxation should be considered as tax expenditures.

For example, regarding the personal and corporate income tax systems as completely separate would suggest that the dividend tax credit is a tax expenditure. However, the credit is an essential feature of the overall (i.e. both corporate and personal) income tax structure and serves to eliminate or reduce double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation and once at the personal level. For this reason, the dividend tax credit is not considered to be a tax expenditure.

Similarly, the non-taxation of inter-corporate dividends is designed to ensure that income already taxed in one corporation is not taxed again upon receipt of a dividend by another corporation. Without this exemption, double taxation

would occur and the corporate income tax system would not be neutral across organizational structures. For example, consider a single corporation that currently operates as a number of divisions. Now suppose it reorganizes into a holding company with wholly owned subsidiaries instead of divisions. The profits from the subsidiaries flow to the holding company through inter-corporate dividends. If these dividends were subject to taxation at both the subsidiary and the holding company levels, double taxation would occur. Consequently, the exemption of inter-corporate dividends is not considered a tax expenditure.

Similar reasoning applies to the tax exemption on income of foreign affiliates of Canadian corporations. Canada either exempts certain dividend income paid by foreign affiliates from Canadian corporate income tax or it provides a foreign tax credit for income taxes paid in the other country. In either case, the intention is to ensure that income is not subject to double taxation (i.e. once in the country of residence of the foreign affiliate and once again in Canada when the dividends are paid out). A further discussion of this topic and the possible benchmarks that could be considered is contained in Chapter 4.

Information on some of these measures that provide relief from "double taxation" is provided in the appropriate memorandum sections of this report.

The benchmark for the income tax system

The definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. A broadly based system is used as the benchmark for income taxes in this report. The essential features are:

Personal income tax

- *the existing tax rates and income brackets are taken as given;*
- *the tax unit is the individual;*
- *taxation is imposed on a calendar year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *structural features of the overall tax system, such as the dividend gross up and credit, are incorporated.*

Corporate income tax

- *the existing general tax rate is taken as given;*
- *the tax unit is the corporation;*
- *taxation is imposed on a fiscal year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *structural features of the overall tax system, such as the non-taxation of inter-corporate dividends, are incorporated.*

Tax Expenditures in the Goods and Services Tax[1]

The benchmark system used to analyze the GST is a broadly based, multi-stage value-added tax collected according to the destination principle and using a tax credit mechanism to relieve the tax in the case of business inputs. The following provides a more detailed discussion of the features of the GST benchmark.

(1) Multi-stage system

The main structural elements of a multi-stage consumption tax are taken to be part of the benchmark. Under the multi-stage system, tax is applied to the sales of goods and services at all stages of the production and marketing chain. At each stage, however, businesses are able to claim tax credits to recover the tax they paid on their business inputs. In this way, the tax system has the effect of applying the tax only to the value added by each business. Since the only tax that is not refunded is the tax collected on sales to final consumers, the tax rests ultimately on final consumption.

(2) Destination-based approach

The benchmark system applies tax only to goods and services consumed in Canada. Accordingly, the tax applies to imports as well as domestically produced goods and services. Exports are not subject to the tax.

(3) Single tax rate

The benchmark system has only one tax rate. This rate corresponds to the statutory rate of 7 per cent. As a result, GST provisions that depart from this single rate are considered to be tax expenditures.

(4) Taxation period

The benchmark taxation period is the calendar year.

(5) Constitutional provisions for government sectors

Section 125 of the *Constitution Act*, 1867, provides that “no land or property belonging to Canada or any province shall be liable to taxation”. This means that neither the federal nor the provincial governments (or their Crown agents) are liable to taxation by the other. Accordingly, constitutional immunity from taxation is recognized as part of the benchmark system for the GST.

The benchmark also recognizes that the federal and provincial governments have taken steps to simplify the operation of the tax for transactions involving government sectors.

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[1] It should be noted that this analysis deals only with the GST and not with other commodity taxes (e.g., excise taxes). The exclusion of these other commodity taxes recognizes the inherent conceptual difficulties of defining an appropriate benchmark system in the context of a tax which is applied to a specific commodity. Work is continuing on defining an appropriate benchmark system which would allow the future measurement of the associated tax expenditures.

- The federal government decided to apply the GST to purchases by federal departments and Crown corporations in order to keep the tax as simple as possible for vendors. As a result, the GST and the benchmark system treat federal Crown corporations in the same manner as any other business entity.
- By virtue of Section 125, provincial governments and Crown agents are not liable to pay the GST on their purchases. However, the federal government and most provinces have entered into Reciprocal Tax Agreements (RTAs). These agreements specify situations in which each level of government agrees to pay the sales taxes of the other, and generally this involves applying tax to purchases made by Crown corporations. As a result, provincial Crown corporations are treated like any other business entity in the benchmark system.

Unlike provincial governments, municipalities are liable to pay the GST. Therefore, the benchmark system considers them as paying tax on their purchases. Universities, colleges, schools and hospitals are also considered to pay tax on their purchases. The GST and the benchmark generally treat these sectors as final consumers – that is, they pay GST on their purchases, they do not claim input tax credits and they do not collect GST on their sales.

The only exception to this benchmark treatment arises from the fact that municipalities, universities, colleges, schools and hospitals engage in certain commercial activities analogous to those provided in the private sector. For example, some municipalities operate golf courses. Such commercial activities are taxable under the GST and the GST paid on associated inputs can be claimed as input tax credits.

The benchmark for the goods and services tax

The essential features are:

- *basic structural features of a broadly based, multi-stage tax system;*
- *destination approach;*
- *7-per-cent rate;*
- *calendar year basis for the taxation period; and*
- *recognition of constitutional provisions for government sectors.*

Types of GST tax expenditures

Comparing the actual structure of the GST to the benchmark system, it is possible to identify four types of tax expenditure:

- zero-rated goods and services;
- tax-exempt goods and services;
- tax rebates; and
- tax credits.

(1) Zero-rated goods and services

Under the GST, certain categories of goods and services are considered to be taxed at a "zero" rate, rather than at the general tax rate of 7 per cent. Vendors do not charge GST on their sales of zero-rated goods and services (whether these sales are to other businesses or to final consumers). However, vendors are entitled to claim input tax credits to recover the GST they paid on inputs used to produce zero-rated products. As a result, zero-rated goods and services are tax free.

One category of zero-rated sales is basic groceries – i.e. foods intended to be prepared and consumed at home. Other categories of zero-rated sales include prescription drugs, medical devices and most agricultural and fish products.

(2) Tax-exempt goods and services

Some types of goods and services are exempt under the GST. This means that the GST is not applied to these sales. Unlike zero-rated goods and services, however, vendors of exempt products are not entitled to claim input tax credits to recover the GST they paid on their inputs to these products.

Examples of tax-exempt goods and services include long-term residential rents, most health and dental care services, day-care services, most sales by charities, most domestic financial services, municipal transit and legal aid services.

(3) Tax rebates

Certain sectors are eligible for rebates on a portion of the GST paid on inputs. For example, there are rebates for schools, universities, hospitals and municipalities. To the extent that these sectors make taxable sales, they can claim input tax credits to recover the tax they paid on inputs to these sales. Where they provide tax-exempt services, however, they are eligible to receive rebates for only a portion of the GST paid on their inputs to these services. These rebates ensure that these institutions do not bear a greater tax burden on their purchases under the GST than they would have under the manufacturers' sales tax, which the GST replaced. This treatment constitutes a tax expenditure because, under the benchmark system, these institutions are considered to be final consumers.

Other examples of tax rebates include the rebates for charities, substantially government-funded non-profit organizations and newly built housing. Also, foreign visitors to Canada are able to claim a rebate for the GST they pay on hotel accommodation and on goods they take home. Only the rebate for hotel accommodation is considered to be a tax expenditure, however, because goods taken home by foreign visitors are effectively exports which are not taxable under the benchmark system.

(4) GST credit[2]

To ensure that the GST system is fair, a GST credit is provided through the personal income tax system to single individuals and families with low and moderate incomes. The credit is paid by cheque four times a year in equal instalments. The total amount of the credit people receive depends on family size and income and is calculated annually based on information provided in the personal income tax return.

GST tax expenditures:

- *zero-rated goods and services;*
- *tax-exempt goods and services;*
- *tax rebates; and*
- *tax credits.*

Memorandum items for the goods and services tax

As indicated earlier, some tax measures are presented as memorandum items even though they are not generally considered to be tax expenditures. For example, the refund of GST for certain employees' expenses is included as a memorandum item.

Many employees, such as commission salespeople, incur significant expenses in the course of carrying out their duties. Examples include restaurant meals and automobile expenses. Often, such expenses are not reimbursed by employers except indirectly through the salaries and commissions paid to employees. Since employees are not considered to be carrying on a commercial activity, they are not able to claim input tax credits for the GST they paid on these expenses. However, employees can receive a refund of the GST paid on those employment expenses that are deductible for income tax purposes. The refund of GST paid on employees' personal consumption

[2] It should be noted that there was a small business transitional credit which accompanied the introduction of the GST. This temporary measure provided a one-time credit of up to $1,000 to GST registrants whose taxable sales did not exceed $500,000 in their first full quarter of 1991 or in any three-month period beginning in 1990.

expenses would constitute a tax expenditure. However, it is not possible to determine exactly what portion of these expenses should be considered personal consumption. Therefore, the refunds of GST paid on employees' expenses are reported as memorandum items. The memorandum items for the GST are discussed in more detail in Chapter 5.

Calculation and Interpretation of the Estimates

The estimates indicate the annual cash flow impact to the government of each particular measure, and not their long-run or steady state revenue cost, subject to the following limitations:

- all measures are evaluated independently; and
- all other factors remain unchanged.

These methodological distinctions are important and have implications for the interpretation of the estimates. These concepts are discussed in further detail below.

Independent estimates

The estimate of the cost of each tax expenditure is undertaken separately, assuming that all other tax provisions remain unchanged. An important implication of this is that the estimates cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

As explained in more detail in the following paragraphs, this restriction arises from the fact that:

- the income tax rate structure is progressive; and
- tax measures interact with one another.

(1) Progressive income tax rates

The combined effect of claiming a number of income tax exemptions and deductions may be to move an individual to a lower tax bracket than would have applied had none of the tax measures existed. To the extent that this occurs, aggregation of the individual estimates may underrepresent the "true" cost to the federal government of maintaining all of them. For example, consider a taxpayer whose taxable income was $1,000 below the level at which he or she would move from the 17-per-cent into the 26-per-cent tax bracket. Imagine that this taxpayer arrives at this level of taxable income by using two tax deductions of $1,000 each (e.g., home relocation loan and registered retirement savings plan (RRSP) contribution). Eliminating either deduction by itself would increase taxable income by $1,000 and the taxpayer's federal tax liability by $170. Eliminating both measures simultaneously, however, would not raise the tax liability by $170 + $170, but rather by $170 + $260.

Aggregating the individual estimates for these two items would provide a misleading impression of the revenue impact of eliminating both of them. Therefore, the estimates in this document cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

While there is only one statutory tax rate for corporations, the small business deduction creates a de facto progressive tax rate schedule for some corporations. In this way, the above argument is valid for the corporate income tax system as well, although the effect is not as large as for personal income taxes.

(2) Interaction of tax measures

As noted above, the estimates are computed one at a time, assuming all other provisions remain unchanged. Given that tax provisions sometimes interact, the total cost of a group of tax expenditures calculated individually may differ from the dollar value of calculating the cost of the same group of tax expenditures concurrently. This is because adding the independently estimated costs of the tax provisions would result in double counting and so would not provide an accurate measure of the revenue which would be generated by simultaneously altering a group of measures.

For example, consider the non-taxation of veterans' allowances, which reduces the recipient's net income. Many measures, such as the medical expense credit, are calculated on the basis of net income. Thus, the reported estimate for the non-taxation of veterans' allowances represents not only the direct impact on government receipts of not taxing the allowances, but also the indirect impact of the change on the cost of other tax measures (such as the medical expense credit) which depend on net income.

Since estimates for GST tax expenditures are made using the same methodological approach as for income taxes, they too cannot be aggregated because they may interact. The following discussion of hospital rebates and zero-rating of prescription drugs illustrates the differences between independent and concurrent estimates for these two provisions.

- Eliminating hospital rebates: If hospital rebates were eliminated, hospitals would no longer be able to recover 83 per cent of the GST they pay on their purchases[3] . However, they could continue to purchase prescription drugs on a tax-free basis because these drugs are zero-rated. The estimate for hospital rebates recognizes that the rebate would not have been claimed in respect of zero-rated prescription drugs.

[3] Most services provided by hospitals are exempt from the GST. This means that no tax is charged on these services but input tax credits cannot be claimed to recover the tax paid on inputs. However, hospitals are able to claim a rebate of 83 per cent of the GST paid on the inputs they use to provide exempt services.

- Eliminating the two measures concurrently has a revenue impact greater than the sum of the independent estimates because the GST would be payable on prescription drugs and hospitals would be unable to claim a rebate for these purchases.
- Eliminating the zero-rating of prescription drugs: If prescription drugs were taxed at the GST rate of 7 per cent, then hospitals would pay the tax on their drug purchases but recover 83 per cent of the tax through the rebate system. Therefore, the estimate for the zero-rating of prescription drugs is calculated as net of the expected increase in the payment of hospital rebates.

Aggregation of estimates

The estimates for individual tax expenditures cannot be added together to determine the total cost of tax expenditures. There are two reasons for this:

- *The simultaneous elimination of more than one income tax expenditure would generate different estimates because of progressive income tax rates.*
- *Given the interaction of certain tax measures, the revenue impact of eliminating two or more measures simultaneously would differ from taking the independently estimated numbers published in this document and simply aggregating them.*

All other factors remain unchanged

The estimates in this report represent the amount by which federal tax revenues were reduced due to the existence of each preference assuming that all other factors remain unchanged.

In order to evaluate the extent of the revenue reduction, the approach taken here is to recalculate federal revenues assuming the measure in question has been eliminated. The difference between this recalculated figure and actual revenues provides the quantitative estimate of the cost of the tax expenditure.

The assumption that all other things remain the same means that no allowance is made for (1) behavioural responses by taxpayers, (2) consequential government policy changes, or (3) changes in tax collections due to altered levels of aggregate economic activity which might result from the elimination of a particular tax measure (further detail is provided on the following two pages). Incorporating these factors would add a large subjective element to the calculations.

(1) Absence of behavioural responses

In many instances, the removal of a tax expenditure would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay, perhaps by making greater use of other tax measures. Therefore, the omission of behavioural responses in the estimating methodology generates cost estimates which may exceed the revenue increases that would have resulted if a particular provision had been eliminated.

As one example, consider the case of the deduction for RRSP contributions. Eliminating this provision would result in the amount of additional federal revenue indicated in the report only if the contributions were not directed to an alternative tax-preferred form of saving. However, the absence of the RRSP deduction might encourage individuals to place their funds instead in some other tax-favoured instrument, such as a labour-sponsored venture capital corporation. If such a response did occur, eliminating the RRSP deduction would result in a smaller increase in revenues than that indicated.

The effects of this assumption can also be illustrated for the GST by considering the housing rebate. Homeowners are eligible for a rebate of the GST they pay on the purchase of new houses. If this rebate was eliminated, the price of new houses would increase relative to the price of used houses. This, in turn, might reduce the demand for new houses while increasing the demand for used houses (which are tax exempt). Since the dynamics of the housing market are not taken into account, the revenues obtained by eliminating the housing rebate could actually be lower than the indicated estimate.

(2) Consequential government policy changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and take no account of other consequential changes in government policy. For example, if the government was to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates in this report do not provide for any such transitional relief.

Similarly, the estimates make no allowance for consequential government policy changes. For example, if lottery winnings were made taxable under the personal income tax system, an argument could be made that the cost of tickets should be deductible in the same way as other investment expenses. Furthermore, it may not be possible to track and assess small gambling winnings. This may mean that a threshold under which winnings would be non-taxable would be required. However, in calculating the cost of providing the exemption for lottery winnings, no allowance is made for such hypothetical consequential government policy changes.

(3) Impact on economic activity

The estimates do not take into account the potential impact of a particular tax provision on the overall level of economic activity and thus aggregate tax revenues. For example, although eliminating the low corporate tax rate for manufacturing and processing could generate a significant amount of revenue for the government, the amount of manufacturing activity could decline, resulting in possible job losses, a reduction in taxable income and hence a reduction in the aggregate amount of tax revenue collected. Furthermore, the derivation of the estimates does not include speculation on how the government might use the additional funds available to it and the possible impacts this could have on other tax revenues.

How to interpret the estimates

Each estimate in this report represents the amount by which federal tax revenues were reduced due to the tax expenditure assuming that all other factors remain unchanged. The estimates do not take into account changes in taxpayer behaviour, consequential government actions or feedbacks on aggregate tax collections through induced changes in economic activity. Accordingly, the elimination of a tax expenditure would not necessarily yield the full tax revenues shown in Tables 1, 2 and 3 in Chapter 2.

Developing Historical Estimates

The majority of the personal income tax estimates in this report were computed with a personal income tax model. This model simulates changes to the personal income tax system using the statistical sample of tax returns collected by Revenue Canada for its annual publication *Taxation Statistics*. The model estimates the revenue impact of possible tax changes by recomputing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the moving expense deduction would result not only in a change in net income but also in all of the credits, such as the medical expense tax credit, whose values depend on net income. For those tax expenditures whose costs could not be estimated using this model alone, supplementary data were acquired from a variety of sources. Details on data sources and the methodologies used for estimating the cost of specific personal income tax measures are provided in Chapter 3.

A corporate income tax model was used to measure most of the corporate tax expenditures. As with the personal income tax model, it is based on a statistical sample of tax returns collected by Revenue Canada, and is able to recompute taxes payable on the basis of adjusted tax provisions. This recomputation of taxes takes into account the availability of unused tax

credits, deductions and losses that would be used by the corporation to minimize its tax liability. Where costs could not be estimated using this model alone, supplementary data acquired from a variety of sources were used. Details on these sources are provided in Chapter 4.

Estimating the cost of tax deferrals presents a number of methodological difficulties since, even though the tax is not currently received, it may be collected at some point in the future. It is therefore necessary to derive estimates of the cost to the government of providing such a tax deferral while, at the same time, ensuring comparability with the other estimates presented here.

In this report, income tax deferrals are estimated on a “current cash-flow” basis – that is, the cost is computed as the foregone tax revenue associated with the additional net deferral in the year (deductions for the current year less the income inclusion from previous deferrals). The estimates thus computed provide a reasonably accurate picture of the ongoing costs of maintaining a particular tax provision in a mature tax system. They can be aggregated over time without double counting and are comparable to estimates of the costs associated with tax credits and deductions.

The costs of the majority of the GST tax expenditures presented in this report were estimated using a Sales Tax Model based on Statistics Canada input-output tables and the National Income and Expenditure Accounts. In cases where estimates were not derived using this model, supplementary data from a variety of sources were used. Details on both the data sources and methodologies are provided in Chapter 5.

Developing Future Projections

As with the historical estimates, the projections represent the estimated amount by which the federal tax revenues would be reduced due to the tax expenditure, assuming that all measures are evaluated independently. This means that the projections cannot be aggregated. In addition, it is assumed that all other factors remain unchanged. Thus, the projections make no provision for any behavioural change that might result from the removal of the provision; for any consequential policy changes that might accompany the change; or for the possible impact of the change on overall economic activity and thus on tax revenues. The projections do, however, take into consideration the impact of announced tax changes.

In contrast to the estimates of tax expenditures for the historical period, when values of the tax expenditures can generally be obtained from tax statistics or other historical data, projections of tax expenditures must rely on estimated relationships between tax expenditures and explanatory economic variables. Using these relationships, the values for the explanatory variables are projected into the future and so permit an estimation of the future expected values of tax expenditures. Key explanatory variables are generally those reflecting the state of the economy.

Projections for the explanatory variables are either based upon the 1997 budget forecasts (e.g., gross domestic product (GDP), population, employment, corporate profits, inflation, consumer spending) or on past trends in the tax expenditure. Where projected tax expenditures were not obtained using these approaches, information on the alternative methodology is provided in Chapter 3 for personal income tax, Chapter 4 for corporate income tax and Chapter 5 for GST tax expenditures.

Any projections are inherently subject to forecast error and substantial errors at times. Those familiar with forecasts prepared for the Canadian economy, or for any other economy, recognize that forecasting is not a science. Future values for key explanatory variables are based on best judgements and unchanged policies are assumed for the forecast period. Furthermore, the relationships between variables that are being explained and those that provide the explanation may not be robust and could quickly change over time. For all these reasons, the projected values of tax expenditures should be treated as "best efforts", which do not have any greater degree of reliability than the variables that explain them. For example, if the level of GDP explains a tax expenditure, one would not expect the projected level of tax expenditure to materialize if the expected level of GDP did not occur. Even if the expected level of GDP did materialize, the level of the tax expenditure might still not if, in the future, the relationship between the tax expenditure and GDP turns out to be different from that estimated on average in the past. Therefore, in general, one should expect that the degree of reliability of the projected tax expenditures should be less than that of the underlying explanatory variables.

Comparison With Direct Expenditures

In comparing the cost of the tax expenditures in this report to direct spending estimates, it should be noted that a dollar of tax preference is often worth substantially more to the taxpayer than a dollar of direct spending. This results from the fact that, in most cases, government grants (i.e. direct spending) are taxable to the recipients. For example, consider an individual facing a marginal tax rate of 29 per cent. A deduction of $100 would be worth $29. If, instead, the government was to provide the individual with a taxable grant of $29, after-tax income would increase by only $20.59 since he/she would face an income tax liability of $8.41 ($29 x 29 per cent).

The same conclusions do not always apply to tax expenditures provided to corporate taxpayers. Consider, for example, an investment tax credit to a corporation with respect to capital equipment acquired to carry out scientific research and experimental development (SR&ED) in Canada. The cost to the government of providing a 20-per-cent tax credit would, in most circumstances, be the same as it would be if the government had provided a direct grant of 20 per cent. This is because investment tax credits are considered to be assistance and are therefore treated in the same manner as direct government grants or subsidies. The 20-per-cent tax credit, like a direct grant, is either included in income, and subject to corporate income tax, or it reduces the capital or other costs deductible by the taxpayer.

Chapter 2

Estimates and Projections

Tables 1 to 3 provide tax expenditure values for personal income tax, corporate income tax and GST for the years 1992 to 1999. In the case of personal income tax, tax expenditures are grouped according to functional categories. This grouping into functional categories is not intended as a policy justification for the specific provisions nor is it the case that all tax measures fall neatly into one of the categories. The categories are provided solely for organizational purposes.

All estimates are reported in millions of dollars. The letter "S" indicates that the cost is less than $2.5 million while "n.a." signifies that data were not available. The inclusion in the report of items for which estimates are not available is warranted given that the report is designed to provide information on the type of assistance delivered through the tax system even if it is not always possible to provide a quantitative estimate. Work is continuing to obtain quantitative estimates where possible. For example, the corporate income tax entries dealing with loss carry-overs were "n.a." in last year's report. In this year's publication, dollar values are reported for these tax expenditures.

Interpreting the estimates and projections

Care should be taken in interpreting the estimates and projections in the following tables:

- *tax expenditures are values of tax revenues foregone to achieve a variety of economic and social objectives. Whether or not the magnitudes of tax expenditures are appropriate depends upon an evaluation of the social and economic policies that generated them. The values reported in the tables provide no information towards such an evaluation;*
- *the estimates cannot be added together to determine the total cost of tax expenditures;*
- *the estimates assume all other factors remain unchanged (i.e. there is no allowance for behavioural change, consequential government policy changes or changes in aggregate economic activity in response to the change in the tax expenditure); and*
- *in addition to these considerations, the projections are subject to forecast error and are "best efforts" which have no greater degree of reliability than the variables that explain them.*

Table 1
*Personal income tax expenditures**

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Culture and recreation								
Deduction for clergy residence	50	48	49	50	52	52	52	52
Flow-through of CCA on Canadian films[1]	11	16	12	40	–	–	–	–
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S	S	S	S	S	S	S
Write-off of Canadian art purchased by unincorporated business	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assistance for artists	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction for artists and musicians	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of capital gains on gifts of cultural property	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education								
Tuition fee credit[2]	155	175	185	190	200	240	255	275
Education credit[3]	44	43	43	43	52	97	130	140
Education and tuition fee credits transferred[4]	165	190	205	210	280	290	300	315
Carry-forward of tuition and education credits[5]	–	–	–	–	–	–	10	25
Exemption on first $500 of scholarship, fellowship and bursary income	10	7	6	6	6	6	6	6
Deduction of teachers' exchange fund contributions	S	S	S	S	S	S	S	S
Registered education savings plans[6]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

*** The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 17 to 19 for a discussion of the reasons for this.**

Personal income tax expenditures *(cont'd)*

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Employment								
Deduction of home relocation loans	4	3	2	3	3	3	3	3
Non-taxation of allowances to volunteer firefighters	4	4	4	4	4	4	4	4
Northern residents deductions[7]	235	190	155	120	125	125	125	130
Overseas employment credit	27	33	30	30	31	31	31	31
Employee stock options	25	57	56	73	80	93	100	115
Non-taxation of strike pay[8]	9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of salary through leave of absence/sabbatical plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Employee benefit plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Family								
Spousal credit	1,140	1,205	1,190	1,200	1,210	1,215	1,225	1,230
Equivalent-to-spouse credit[9]	585	455	470	465	465	470	470	475
Dependant credit[10]	435	12	10	6	56	56	56	56
Refundable child tax credit[11]	2,360	–	–	–	–	–	–	–
Child tax benefit[12]	–	5,275	5,240	5,230	5,165	5,245	5,650	6,000
Deferral of capital gain through transfer to spouse	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Personal income tax expenditures (cont'd)

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Farming and fishing								
$500,000 lifetime capital gains exemption for farm property[13]	250	405	470	290	305	305	305	305
Net Income Stabilization Account (NISA)[14, 15]								
Deferral of tax on government contributions	n.a.	n.a.	43	29	105	59	59	59
Deferral of tax on bonus and interest income	n.a.	n.a.	8	13	17	30	38	46
Taxable withdrawals	n.a.	n.a.	-15	-14	-32	-20	-20	-20
Deferral of income from destruction of livestock	S	S	S	S	S	S	S	S
Deferral of income from grain sold through cash purchase tickets[16]	-12	-15	46	26	19	19	19	19
Deferral through 10-year capital gain reserve[16]	-30	-5	14	-7	-7	-7	-7	-7
Deferral of capital gain through intergenerational roll-overs of family farms	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Exemption from making quarterly tax instalments	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Cash basis accounting	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Flexibility in inventory accounting	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Federal-provincial financing arrangements								
Québec abatement	2,095	2,140	2,185	2,335	2,460	2,600	2,730	2,870
Transfers of income tax room to provinces	8,700	8,870	9,090	9,745	10,270	10,865	11,460	12,130
General business and investment								
$100,000 lifetime capital gains exemption[17]	735	1,170	8,815	–	–	–	–	–
Partial inclusion of capital gains[18]	260	385	385	405	420	430	445	460

Personal income tax expenditures (cont'd)

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Deduction of limited partnership losses[16, 19]	220	215	295	220	245	245	245	245
Investment tax credit[16, 20]	58	125	70	54	60	60	60	60
Deferral through five-year capital gain reserve[16]	-14	-33	-27	-25	-25	-25	-25	-25
Deferral through capital gains roll-overs	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction of accelerated tax depreciation[21]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
$1,000 capital gain on personal-use property	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
$200 capital gain on foreign exchange transactions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Taxation of capital gains upon realization	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health								
Non-taxation of employer-paid health and dental benefits	1,125	1,200	1,270	1,430	1,445	1,475	1,500	1,525
Disability credit[22]	265	270	275	265	270	270	275	280
Medical expense credit[23]	225	260	260	295	305	355	355	395
Medical expense supplement for earners[5]	–	–	–	–	–	30	30	40
Income maintenance and retirement								
Non-taxation of guaranteed income supplement and spouse's allowance benefits	220	225	260	260	265	270	280	285
Non-taxation of social assistance benefits[24]	595	680	705	670	620	620	620	620
Non-taxation of workers' compensation benefits[16, 25]	610	610	585	625	610	610	610	610
Non-taxation of amounts received as damages in respect of personal injury or death	17	18	20	20	20	20	20	20

Personal income tax expenditures (cont'd)

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Non-taxation of employer-paid premiums for group term life insurance of up to $25,000[26]	160	165	87	–	–	–	–	–
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)[27]	7	6	6	4	3	S	S	S
Non-taxation of veterans' disability pension and support for dependants	140	140	140	140	140	140	140	140
Treatment of alimony and maintenance payments[28]	200	220	260	270	285	250	255	255
Age credit[29]	1,355	1,370	1,290	1,255	1,290	1,310	1,350	1,380
Pension income credit	295	305	325	340	350	360	365	370
Saskatchewan pension credit	S	S	S	S	S	S	S	S
Registered retirement savings plans								
Deduction for contributions	3,685	4,490	4,785	5,405	5,945	6,540	7,195	7,915
Non-taxation of investment income	2,760	3,325	3,565	4,080	4,605	5,180	5,825	6,545
Taxation of withdrawals	-1,000	-930	-1,620	-1,765	-1,930	-2,105	-2,300	-2,515
Registered pension plans								
Deduction for contributions	4,990	5,205	4,890	5,180	5,490	5,820	6,170	6,540
Non-taxation of investment income	7,865	8,610	9,540	10,260	10,915	11,580	12,250	12,930
Taxation of withdrawals	-4,580	-4,930	-4,010	-4,490	-5,030	-5,630	-6,310	-7,065
Non-taxation of RCMP pension/compensation in respect of injury, disability or death[30]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferred profit-sharing plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Personal income tax expenditures (cont'd)

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
	($ millions)							
Non-taxation of up to $10,000 of death benefit	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of investment income on life insurance policies[31]	–	–	–	–	–	–	–	–
Small business								
$500,000 lifetime capital gains exemption for small business shares[16, 32]	785	1,170	1,725	630	685	685	685	685
Deduction of allowable business investment losses[16]	89	100	77	79	82	82	82	82
Labour-sponsored venture capital corporations' credit[33]	62	58	110	235	105	105	110	115
Deferral through 10-year capital gain reserve	-7	5	4	0	0	0	0	0
Other items								
Non-taxation of capital gains on principal residences[34]								
Partial inclusion rate	2,410	1,790	1,795	1,080	1,200	1,170	1,010	1,005
Full inclusion rate	3,215	2,385	2,390	1,440	1,600	1,555	1,350	1,340
Non-taxation of income from the Office of the Governor General	S	S	S	S	S	S	S	S
Assistance for prospectors and grubstakers	S	S	S	S	S	S	S	S
Charitable donations credit[35]	865	880	900	940	1,035	1,190	1,250	1,310
Reduced inclusion rate for capital gains arising from certain charitable donations[5]	–	–	–	–	–	90	95	100
Gifts to the Crown credit	17	14	21	18	18	18	18	18
Political contribution credit	10	20	9	10	13	13	13	13

Personal income tax expenditures (cont'd)

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Non-taxation of income of Indians on reserves	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of gifts and bequests	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memorandum items								
Non-taxation of lottery and gambling winnings[36]	905	910	960	985	1,020	1,050	1,080	1,110
Non-taxation of allowances to certain public officials	5	6	6	6	6	6	6	6
Non-taxation of allowances for diplomats and other government employees posted abroad	10	8	8	9	9	9	9	9
Child care expense deduction[37]	315	305	305	320	335	340	345	350
Attendant care expense deduction	S	S	S	S	S	S	S	S
Moving expense deduction[16]	59	66	64	60	60	60	60	60
Deduction of carrying charges incurred to earn income[16, 38]	585	540	540	625	560	560	560	560
Deduction of meals and entertainment expenses[39]	80	110	110	97	95	95	95	95
Deduction of farm losses for part-time farmers	52	50	48	54	52	52	52	52
Farm and fishing loss carry-overs[16]	11	11	9	9	10	10	10	10
Capital loss carry-overs[16]	50	89	87	73	73	73	73	73
Non-capital loss carry-overs[16]	53	73	74	64	64	64	64	64
Logging tax credit	S	S	S	S	S	S	S	S
Deduction of resource-related expenditures	51	78	77	76	75	75	75	75
Deduction of other employment expenses[40]	455	490	540	515	530	555	575	600
Deduction of union and professional dues	440	465	465	480	485	495	505	510

Personal income tax expenditures (cont'd)

	Estimates			Projections				
	1992	1993	1994	1995	1996	1997	1998	1999
	($ millions)							
Employment insurance								
Employment insurance contribution credit	1,220	1,230	1,300	1,305	1,265	1,300	1,305	1,325
Non-taxation of employer-paid premiums	2,485	2,510	2,655	2,670	2,585	2,655	2,670	2,715
Canada and Quebec pension plans								
Canada and Quebec pension plan credit	930	985	1,055	1,125	1,105	1,205	1,375	1,575
Non-taxation of employer-paid premiums	1,210	1,270	1,360	1,450	1,425	1,555	1,775	2,030
Foreign tax credit[41]	150	185	220	270	310	355	395	440
Dividend gross-up and credit	640	635	645	765	730	795	840	880
Basic personal credit	17,265	17,130	17,325	17,430	17,725	17,740	18,090	18,420
Non-taxation of capital dividends	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes

1 The increase in this tax expenditure in 1995 reflects increases in the average amount of CCA claimed and the number of individuals claiming CCA in that year, based on preliminary figures. The flow-through of CCA on Canadian films is not available for taxation years later than 1995, and is replaced by a tax credit to producers.

2 The 1997 budget proposed to extend this credit to most mandatory ancillary fees imposed by post-secondary institutions, beginning in 1997.

3 The 1996 budget increased this credit from $80 to $100 per month, beginning in 1996. The 1997 budget proposed to increase this credit to $150 per month for 1997, and $200 per month thereafter.

4 The 1996 budget increased from $4,000 to $5,000 the limit on the transfer of these amounts, beginning in 1996.

5 This measure was proposed in the 1997 budget.

6 Very little information is available. In light of the increasing importance of registered education savings plans (RESPs), the 1997 budget indicated that Revenue Canada will require additional information from RESP trustees, including information on the funds accumulated in these plans. The 1996 and 1997 budgets reported estimates of the revenue cost of changes to RESPs that were based on conservative assumptions about the impact of the measures on take-up.

[7] The lower level of the tax expenditure after 1993 reflects the fact that residents of communities no longer eligible for benefits following the reform of northern benefits were eligible for two-thirds benefits in 1993, one-third benefits in 1994, and none thereafter.

[8] Statistics Canada no longer collects data on strike pay in Canada.

[9] The decline in this tax expenditure between 1992 and 1993 reflects the change in the definition of spouse to include common-law spouses.

[10] Starting 1993 with the introduction of the child tax benefit, the dependant credit can no longer be claimed for children under age 17. The decline in this tax expenditure for 1995 reflects a 35-per-cent decrease in the number of claimants in that year, based on preliminary figures. The 1996 budget increased the maximum credit per dependant from $270 to $400.

[11] Payments in respect of the taxation year. This credit was eliminated with the introduction of the child tax benefit in 1993.

[12] The 1996 and 1997 budgets proposed enrichments to this tax benefit (see Chapter 3). Payments made between January and December of the year are reported.

[13] The decline in this tax expenditure in 1995 reflects a 20-per-cent decrease in the number of claimants, and a 25-per-cent decrease in the average claim in that year, based on preliminary figures.

[14] The data used to determine the Net Income Stabilization Account tax expenditures for years 1992 and 1993 published in the 1995 report were on an accrual basis. Since data on a cash basis are not available, the tax expenditures for years 1992 and 1993 cannot be estimated.

[15] The high level of this tax expenditure in 1996 reflects special start-up payments to farmers in Saskatchewan in that year.

[16] This tax expenditure is highly volatile. It is projected at its historical average.

[17] The large increase in this tax expenditure in 1994 reflects the special election to claim the exemption for eligible capital gains accrued up to February 22, 1994 on 1994 tax returns. The lifetime capital gains exemption for general property is not available for taxation years later than 1994.

[18] Estimates of this tax expenditure published in previous editions have been revised to better reflect the effect of the various capital gains exemptions on this measure.

[19] The high value of this tax expenditure in 1994 reflects a 40-per-cent increase in the average loss claim in that year.

[20] The high value of this tax expenditure in 1993 reflects a temporary small business investment tax credit. The tax credit was provided for investments in eligible machinery and equipment made after December 2, 1992 and before 1994.

[21] This tax expenditure includes the deduction of scientific research and experimental development expenditures. Accurate data are not available to estimate with precision this tax expenditure.

[22] The decline in this tax expenditure in 1995 reflects a 5-per-cent decline in the number of claimants in that year, based on preliminary figures.

[23] The 1997 budget proposed a broadening of this credit to cover additional expenses, beginning in 1997.

[24] Estimates of this tax expenditure published in previous editions have been revised to reflect the availability of updated social assistance expenditure data from Human Resources Development Canada. The declines in this tax expenditure in 1995 and 1996 reflect preliminary information, suggesting lower levels in future years.

[25] The increase in this tax expenditure in 1995 reflects a 10-per-cent increase in the number of claimants in that year, based on preliminary figures, which is not expected to continue.

[26] These amounts became taxable after July 1, 1994.

[27] The expected decrease in this tax expenditure is in line with the historical trend.

[28] The 1996 budget eliminated the income inclusion for recipients of child support payments, and disallowed the deduction to payers, for agreements made after April 30, 1997.

[29] These amounts became income-tested in 1994.

[30] The amounts reported in previous years for this tax expenditure included taxable amounts and did not cover all non-taxable RCMP pensions. Accurate data are not available to estimate with precision this tax expenditure.

[31] Although this measure does provide tax relief for individuals, it is implemented through the corporate tax system. See the corporate income tax expenditure chapter of this report for an estimate of the value of this tax expenditure.

[32] The high value of this tax expenditure in 1994 reflects a 30-per-cent increase in the average claim in that year. The decline in this tax expenditure in 1995 reflects a 50-per-cent decline in the number of claimants, and a 15-per-cent decline in the average claim in that year, based on preliminary figures.

[33] The high value of this tax expenditure in 1995 reflects record sales of shares of labour-sponsored venture capital corporations for that year. The 1996 budget reduced this credit from 20 to 15 per cent, and the purchase amount eligible for credit from $5,000 to $3,500 per year, for purchases made after March 5, 1996.

[34] The 1992 and 1993 estimates have been revised to reflect improved multiple listing service (MLS) housing price data. The decline in this tax expenditure in 1995 reflects declines in home values and home sales in that year. Overall, this tax expenditure is expected to remain below its 1994 value, reflecting projected home values and sales.

[35] The 1994 budget lowered the threshold at which charitable donations begin to earn the 29-per-cent credit from $250 to $200. The 1996 and 1997 budgets proposed additional enrichments to this credit (see Chapter 3).

[36] This estimate assumes that the total amount of lottery and horse-racing winnings would be included in income and subject to tax. However, there is some uncertainty regarding the proper benchmark tax system in this area. For example, if the benchmark system included taxation of winnings, it would also have to include a deduction for the purchase cost of tickets. A threshold below which winnings would not be taxable may also be necessary, due to the large administrative cost of taxing very small prizes. In addition, proceeds from the sale of lottery tickets are an important source of funds for provincial governments. As a result, there is already an element of taxation to lottery and gambling proceeds. This estimate is therefore included as a memorandum item only.

[37] The 1996 budget broadened eligibility criteria for claiming this deduction, beginning in 1996.

[38] The increase in this tax expenditure in 1995 reflects a 10-per-cent increase in the average claim in that year, based on preliminary figures, which is not expected to continue.

[39] The deduction is limited to 50 per cent of eligible amounts incurred after February 22, 1994. Amounts incurred earlier were deductible at 80 per cent.

[40] The high level of this tax expenditure in 1994 reflects a 25-per-cent increase in the number of claimants in that year. The decline in this tax expenditure in 1995 reflects a 5-per-cent decline in the average claim in that year, based on preliminary figures.

[41] The expected increase in this tax expenditure is in line with the historical trend.

Table 2
*Corporate income tax expenditures**

	Estimates		Projections					
	1992**[1]	1993**	1994	1995	1996	1997	1998	1999
				($ millions)				
Tax rate reductions								
Low tax rate for small businesses	1,983	2,128	2,390	2,555	2,570	2,620	2,770	2,780
Low tax rate for manufacturing and processing[2]	367	523	1,080	1,525	1,530	1,560	1,650	1,655
Low tax rate for credit unions and co-operatives	60	45	47	55	56	57	60	60
Exemption from branch tax for transportation, communication, banking and iron ore mining corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemption from tax for international banking centres	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax credits								
Investment tax credits								
SR&ED investment tax credit[3]	602	787	835	875	920	965	1,015	1,070
Atlantic investment tax credit[4]	34	64	100	120	170	185	250	100
Special investment tax credit[5]	7	21	30	–	–	–	–	–
Cape Breton investment tax credit[6]	3	S	–	–	–	–	–	–
Small business investment tax credit[7]	3	94	82	–	–	–	–	–
ITCs claimed in current year but earned in prior years[8]	215	200	220	235	250	270	285	305
Political contributions tax credit	S	S	S	S	S	S	S	S

* **The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 17 to 19 for a discussion of the reasons for this.**

** **An industry breakdown of 1992 and 1993 corporate tax expenditures can be obtained on request.**

Corporate income tax expenditures *(cont'd)*

	Estimates		Projections					
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Exemptions and deductions								
Partial inclusion of capital gains[9]	439	537	540	555	575	605	635	665
Royalties and mining taxes								
Non-deductibility of Crown royalties and mining taxes	-358	-410	-440	-455	-465	-480	-495	-510
Resource allowance[10]	302	466	510	530	540	555	575	590
Earned depletion[11]	39	49	58	51	40	30	24	12
Deductibility of charitable donations	82	78	100	120	125	130	135	135
Gifts to the Crown	S	S	S	S	S	S	S	S
Non-deductibility of advertising expenses in foreign media	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of provincial assistance for venture investments in small business	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferrals								
Accelerated write-off of capital assets and resource-related expenditures[12]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Allowable business investment losses[13]	45	48	31	32	35	35	37	39
Holdback on progress payments to contractors[14]	7	18	20	17	12	20	19	20
Available for use	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Capital gains taxation on realization basis	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Expensing of advertising costs	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Cash basis accounting	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Corporate income tax expenditures (*cont'd*)

	Estimates		Projections					
	1992	1993	1994	1995	1996	1997	1998	1999
	($ millions)							
Flexibility in inventory accounting	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of income								
On grain sales	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
On destruction of livestock	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of tax from use of billed-basis accounting by professionals	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
International								
Non-taxation of life insurance companies' world income[15]	60	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemptions from non-resident withholding tax[16]								
Copyright royalties[17]	80	81	23	57	60	63	66	69
Royalties for the use of, or right to use, other property	39	40	49	51	150	160	165	175
Interest on deposits	397	325	400	425	420	435	430	420
Interest on long-term corporate debt	450	461	515	545	540	555	555	540
Dividends[17]	80	74	21	52	67	70	79	82
Management fees	10	10	16	17	18	19	19	20
Exemption of income earned by foreign ship and aircraft companies from Canadian income tax	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other tax expenditures								
Transfer of income tax room to provinces in respect of shared programs	353	452	560	695	700	715	755	755
Interest credited to life insurance policies	60	63	70	72	75	79	83	87

Corporate income tax expenditures *(cont'd)*

	Estimates		Projections					
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Non-taxation of registered charities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Income tax exemption for provincial and municipal corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of certain federal Crown corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Excise tax transportation rebate[18]	51	68	S	–	–	–	–	–
Aviation fuel excise tax rebate[19]	–	–	–	–	–	n.a.	n.a.	n.a.
Surtax on the profits of tobacco manufacturers[20]	–	–	-45	-60	-60	-65	-70	-70
Temporary tax on the capital of large deposit-taking institutions[21]	–	–	–	-40	-60	-65	-70	–
Memorandum items								
Refundable Part I tax on investment income of private corporations[22]	816	802	775	815	835	845	910	970
Refundable capital gains for special investment corporations[23]	41	220	185	190	200	210	220	230
Loss carry-overs[24]								
Non-capital losses carried back[25]	1,415	1,034	795	695	905	945	985	1,080
Non-capital losses applied to current year[26]	1,550	2,037	2,285	2,305	2,245	2,500	2,610	2,625
Net capital losses carried back[27]	106	96	65	57	74	78	81	88
Net capital losses applied to current year[28]	101	62	135	135	130	145	155	155
Farm losses applied to current year[29]	6	3	8	9	9	9	10	10
Meals and entertainment expenses[30]	253	263	225	190	195	205	210	220

Corporate income tax expenditures *(cont'd)*

	Estimates		Projections					
	1992	1993	1994	1995	1996	1997	1998	1999
	($ millions)							
Large corporations tax								
Threshold	500	430	480	490	500	510	520	530
Exempt corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Patronage dividend deduction	130	103	145	165	190	190	210	210
Logging tax credit[31]	8	35	86	35	36	37	38	38
Deductibility of Crown royalties (joint venture payments) for the Syncrude project (remission order)[32]	S	4	7	25	18	13	17	11
Deductibility of royalties paid to Indian bands	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-resident-owned investment corporation refund	16	92	105	105	135	140	160	165
Investment corporation deduction	S	S	S	S	S	S	S	S
Deferral of capital gains income through various roll-over provisions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Excess deduction for intangible assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax exemption on income of foreign affiliates of Canadian corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes

[1] The 1992 figures are based upon final data and may differ from the figures in last year's edition of this document which were based on preliminary data.

[2] The increases over the 1992 to 1995 period in the revenue cost of the low tax rate for manufacturing and processing (M&P) profits reflect both a decrease in the tax rate on M&P profits from 23 per cent to 21 per cent and an increase in the level of M&P profits since 1992.

[3] The increase between 1992 and 1993 is largely attributable to an increase in the number of taxpayers claiming SR&ED tax credits.

[4] The projected cost of the tax expenditure declines in 1999 because a large portion of this tax expenditure relates to the Hibernia offshore oil project which will complete its investment phase by the end of 1998.

[5] New investments do not earn this credit after 1994. Credits not claimed in 1994 and prior years may be carried forward. However, they are included in the forecasts for ITCs claimed in current year but earned in prior years.

[6] The Cape Breton investment tax credit was applicable to eligible equipment acquired after May 23, 1985 and before 1993. Cape Breton credits earned before 1993 and claimed after 1993 are included under ITCs claimed in current year but earned in prior years.

[7] Since the small business investment tax credit was available for eligible expenditures on machinery and equipment acquired after December 2, 1992 and before 1994 only, the revenue cost is largely in the 1993 and 1994 taxation years. Unclaimed credits are carried forward and may be claimed in subsequent years. When claimed, these unused credits are included under ITCs claimed in current year but earned in prior years.

[8] The exploration tax credit was available for qualified Canadian exploration expenditures incurred between December 1, 1985 and December 31, 1990. Exploration tax credits earned before 1991 are included under this item when claimed, along with all other ITCs earned in previous years but not claimed until the current year.

[9] The increase between 1992 and 1993 was due to an increase in reported capital gains.

[10] The increase between 1992 and 1993 in revenue cost was due to an increase in the petroleum industry's profitability.

[11] Due to the elimination of the earned depletion allowance, there have been no additions to this tax expenditure pool since 1989. Therefore amounts claimed in the current years relate to depletion earned in 1989 and prior years.

[12] The fast write-off of capital equipment used for SR&ED and of resource-related exploration and development expenditures, which were reported separately in previous publications, are now included under this item.

[13] The tax expenditure for allowable business investment losses fluctuates from year to year depending upon the amount of current year losses and the availability of income against which to apply these losses. The decrease in the tax expenditure amount from 1993 to 1994 results from a projected decrease in the amount of losses realized.

[14] The amount of this tax expenditure can fluctuate significantly from year to year depending primarily upon the level of construction activity.

[15] Information required to estimate this tax expenditure is not available for 1993 and subsequent years.

[16] These estimates are based on the benchmark assumption that no behavioural response would occur after the hypothetical removal of existing withholding tax exemptions. This assumption is particularly difficult to sustain for this type of tax, as indicated in the text, which means that the amounts shown in the table should not be regarded as estimates of the revenue gain that would be realized from the hypothetical removal of the listed withholding tax exemptions.

[17] The decline from 1993 to 1994 is due to a decline in the level of exempt payments made to non-residents. Such a decline can be expected on occasion since the events that trigger such payments will not necessarily occur on a regular basis.

[18] This measure was effective for 1991 and 1992 calendar years only.

[19] This measure will be effective for the years 1997 to 2000 inclusive.

[20] This measure was introduced in 1994 and is scheduled to expire in 2000.

[21] This measure was introduced in 1995 and is scheduled to expire after October 31, 1998.

[22] The decrease from 1993 to 1994 results from a projected decline in the amount of dividends distributed that trigger a refund of a portion of the Part I tax paid.

[23] The increase between 1992 and 1993 is mainly due to an increase in dividends distributed to shareholders. Because the level of dividends distributed to shareholders fluctuates significantly from year to year, the tax expenditure projections are based upon a weighted average of 1992 and 1993 dividend levels.

[24] The tax expenditures for loss carry-overs can fluctuate significantly from year to year depending upon the amount of current and prior years' losses and the availability of income against which to apply these losses.

[25] The 1989, 1990 and 1991 estimates are respectively $1,124, $1,379 and $1,671 million. The decrease in the tax expenditure amount over the 1992 to 1995 period results from a decrease in the amount of losses available for carry-back to reduce income of prior years.

[26] The 1989, 1990 and 1991 estimates are respectively $1,190, $1,236 and $1,488 million. The increase in the tax expenditure amount over the 1992 to 1994 period results from an increase in the amount of income against which to apply losses of prior years.

[27] The 1989, 1990 and 1991 estimates are respectively $36, $57 and $50 million. The decrease in the tax expenditure amount over the 1992 to 1995 period results from a decrease in the amount of losses available for carry-back to reduce income of prior years.

[28] The 1989, 1990 and 1991 estimates are respectively $68, $104 and $52 million. The increase in the tax expenditure amount between 1993 and 1994 results from a projected increase in the amount of income against which to apply losses of prior years.

[29] The 1989, 1990 and 1991 estimates are respectively $6, $5 and $11 million.

[30] The projected decrease in the tax expenditure for meals and entertainment expenses over the 1993 to 1995 period reflects the impact of the decrease in the deductible portion of such expenses from 80 per cent to 50 per cent, effective February 1994. In addition, the current publication reflects a revision in the method of estimating the tax expenditure for this item. The tax expenditures associated with this measure for previous years are now estimated as $247 million for 1989; $281 million for 1990; and $266 million for 1991.

[31] The increase in the revenue cost for this item in 1993 and 1994 can be attributed to an increase in the profitability of the industries subject to logging taxes and the refunds of softwood lumber countervailing duties paid to the U.S. in 1992 and 1993 following a trade tribunal ruling in favour of Canada.

[32] The amount of this tax expenditure can fluctuate significantly from year to year depending primarily upon profitability, provincial royalties, and capital expenditures.

Table 3
GST tax expenditures*

	Estimates				Projections			
	1992	1993	1994	1995	1996	1997	1998	1999
				($ millions)				
Zero-rated goods and services								
Basic groceries[1]	2,465	2,550	2,595	2,675	2,750	2,850	2,960	3,075
Prescription drugs[1]	245	265	275	285	295	305	315	330
Medical devices[1]	130	140	145	150	155	160	165	175
Agricultural and fish products and purchases	S	S	S	S	S	S	S	S
Certain zero-rated purchases made by exporters	S	S	S	S	S	S	S	S
Non-taxable importations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax exempt goods and services								
Long-term residential rent[1]	1,335	1,395	1,450	1,500	1,550	1,605	1,670	1,750
Health care services[1]	310	325	340	355	395	425	455	475
Education services (tuition)[1]	315	330	340	350	370	390	410	425
Child care and personal services[1]	160	170	175	180	190	200	205	215
Legal aid services[1]	30	30	30	30	30	30	35	35
Ferry, road and bridge tolls[1]	5	5	5	5	5	5	5	5
Municipal transit[1]	60	55	50	50	55	55	55	60
Exemption for small business	95	100	105	105	105	110	115	120

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 17 to 19 for a discussion of the reasons for this.

GST tax expenditures (cont'd)

	Estimates				Projections			
	1992	1993	1994	1995	1996	1997	1998	1999
	($ millions)							
Quick method accounting	105	115	130	135	140	145	150	155
Water and basic garbage collection services[1]	80	80	80	85	90	90	95	100
Domestic financial services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Certain supplies made by non-profit organizations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax rebates								
Rebates for municipalities[2]	495	510	530	565	565	565	565	565
Rebates for hospitals[2]	280	275	275	270	270	270	270	270
Rebates for schools[2]	290	305	290	300	300	300	300	300
Rebates for universities[2]	115	120	120	120	120	120	120	120
Rebates for colleges[2]	50	50	50	55	55	55	55	55
Rebates for charities	115	135	135	140	150	155	165	170
Rebates for non-profit organizations	70	100	95	90	95	100	105	110
Rebates for book purchases made by qualifying public institutions[3]	–	–	–	–	S	25	25	25
Housing rebate[4]	520	500	520	415	435	505	565	600
Rebate for foreign visitors on accommodations[5]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Special credit for certified institutions	n.a.	n.a.	n.a.	n.a.	–	–	–	–
Tax credits								
The GST credit	2,490	2,645	2,785	2,820	2,850	2,900	2,950	3,000

GST tax expenditures (cont'd)

	Estimates				Projections			
	1992	1993	1994	1995	1996	1997	1998	1999
	($ millions)							
Memorandum items								
Meals and entertainment expenses[6]	140	145	115	95	100	105	105	110
Rebate to employees and partners	55	65	70	60	65	65	70	70
Sales of personal-use real property	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes

1 Estimates of this tax expenditure have been revised as a result of changes to the underlying non-taxable proportions used in the Sales Tax Model and changes to the data obtained from Statistics Canada's National Income and Expenditure Accounts.

2 Since the value of this tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1995.

3 This measure was introduced in October 1996.

4 Estimates of this tax expenditure have been revised based on more recent Statistics Canada's National Income and Expenditure Accounts data. The sharp decline in 1995 reflects the significant weakness in residential construction in that year.

5 Estimates of this tax expenditure are no longer available since the relevant administrative data are not sufficient to reliably identify the revenue consequences of this provision.

6 The estimates have been revised reflecting the fact that the numerical approach used to derive the tax expenditure figures has been more tightly integrated with the tax expenditure estimates reported for the personal and corporate tax system. The decline in 1994 largely reflects the reduction in the eligibility limit for meals and entertainment expenses from 80 per cent to 50 per cent.

Chapter 3:

Description of Personal Income Tax Provisions

The descriptions of the specific tax measures contained in this chapter are intended as a simplified reference and are not detailed descriptions of specific tax measures.

A number of measures which primarily affect corporations, but also unincorporated businesses, are treated in Chapter 4 on the corporate income tax measures.

Explanations of the methodologies used to produce estimates and projections are provided where they deviate from the standard approach of using the personal income tax simulation model described in Chapter 1.

Culture and Recreation

Deduction for clergy residence

A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct housing costs from income for tax purposes. Where a member of the clergy is supplied living accommodation by his/her employer or receives housing allowances, an offsetting deduction may be claimed to the extent that this benefit is included in income. The estimate for this item is based on the number of clergy in Canada and Statistics Canada expenditure data on rent.

Flow through of CCA on Canadian films

Prior to 1995, the capital cost allowance (CCA) rate generally available on films was 30 per cent, subject to the half-year rule. On Canadian content films, the half-year rule did not apply. The CCA could be flowed through to investors and deducted against all sources of income. An additional allowance of up to the remaining undepreciated capital cost of the film was deductible against an investor's income from certified Canadian films.

Losses arising from CCA claimed at the partnership level and flowed through as limited partnership losses are included in the "Deduction of limited partnership losses" tax expenditure. It is estimated that 15 per cent of limited partnership losses relate to CCA on Canadian films.

In the 1995 budget, it was announced that the special tax shelter rules that applied to Canadian content films would be replaced by a 12-per-cent credit that could be claimed only by certain film and video production corporations. Transitional rules for the 1995 taxation year allowed full deductibility of undepreciated capital cost against film income and the flow-through of the CCA to the investor only if the 12-per-cent refundable tax credit was not claimed in respect of the production.

Deduction for certain contributions by individuals who have taken vows of perpetual poverty

Where a person has taken a vow of perpetual poverty as a member of a religious order, that person may deduct donations to the religious order up to his/her total employment and pension income (but not investment or other income) in lieu of the charitable donations credit.

Write-off of Canadian art purchased by unincorporated businesses

Canadian art acquired by businesses for display in an office may be depreciated on a 20-per-cent declining balance basis even though it may depreciate at a much slower rate, and may even appreciate.

No data are available.

Assistance for artists

Artists may deduct the costs of creating a work of art in the year the costs are incurred rather than in the year the work of art is sold.

Artists may also elect to value a charitable gift from their inventories at any amount up to its fair market value. This value is included in the artist's income. The percentage of income limit for the charitable donations tax credit does not apply.

No data are available.

Deduction for artists and musicians

Employed musicians are able to claim the cost of maintenance, rental, insurance and capital cost allowance on musical instruments against employment income earned as a musician.

Employed artists are also entitled to deduct expenses related to their artistic endeavours up to the lesser of $1,000 or 20 per cent of their income derived from employment in the arts.

No data are available.

Non-taxation of capital gains on gifts of cultural property

Certain objects certified as being of cultural importance to Canada are exempt from capital gains tax if donated to a designated museum or art gallery.

Such donations amounted to $101 million in 1994 and $99 million in 1995. However, there is no information on the portion of the value which represents capital gains.

Education

Tuition fee credit

A 17-per-cent tax credit is available for tuition fees paid by students to a prescribed educational institution. A credit is available with respect to fees paid to an institution if the total tuition fees paid to the institution exceed $100. The 1997 budget proposes to extend the credit to most mandatory ancillary fees imposed by post-secondary institutions, starting in 1997.

Education credit

Students who are enrolled at prescribed educational institutions on a full-time basis are entitled to claim a tax credit of 17 per cent of an education amount. The amount is $80 for every month of full-time attendance from 1993 to 1995, and $100 for 1996. The 1997 budget proposes that the amount be increased to $150 for 1997, and to $200 for 1998 and subsequent taxation years.

Education and tuition credits transferred

The unused portions of the education and the tuition fee amounts may be transferred to a supporting spouse, parent or grandparent. The maximum transfer for the two credits combined is 17 per cent of $4,000 for taxation years 1993 to 1995 and $5,000 for 1996 and subsequent taxation years.

Carry-forward of tuition and education credits

The 1997 budget proposes to allow students to carry forward indefinitely for their own use, education and tuition fee amounts that have not been either already used by the student or transferred to a supporting individual.

Exemption on first $500 of scholarship, fellowship and bursary income

The first $500 of scholarship, fellowship and bursary income is exempt from income tax.

The tax expenditures reported in the table are understated since no data are available on individuals receiving scholarship, fellowship or bursary income of less than $500.

Deduction of teachers' exchange fund contributions

Teachers may deduct up to $250 per year in contributions to a fund established by the Canadian Education Association for the benefit of teachers from Commonwealth countries visiting Canada under a teachers' exchange agreement.

Registered education savings plans

A taxpayer may contribute to a registered education savings plan (RESP) on behalf of a designated beneficiary (usually the taxpayer's child). Contributions to RESPs are not deductible, but are usually returned to the subscriber free of tax. The investment return on these funds is not taxable until it is withdrawn for the education of the named beneficiary. Prior to 1998, RESP income may be used only for educational purposes, and is generally taxable in the hands of the beneficiary.

For taxation years 1993, 1994 and 1995, the annual contribution in respect of a beneficiary cannot exceed $1,500 per beneficiary, with an overall limit of $31,500. Effective 1996, the annual limit was increased to $2,000 with an overall limit of $42,000. The 1997 budget proposes to increase the annual limit to $4,000. It also proposes that, where beneficiaries of a plan are not pursuing higher education and a number of other conditions are met, the contributor be allowed to receive RESP income. In particular, a contributor would be allowed to roll over investment income to his/her registered retirement savings plan (RRSP) without penalty, subject to available RRSP room.

No data are available.

Employment

Deduction of home relocation loans

For up to five years, an offsetting deduction from taxable income is provided for the benefit received by an employee in respect of a home relocation loan. The amount of the deduction is the lesser of the amount included in income as a taxable benefit and the amount of the benefit that would arise in respect of an interest-free loan of $25,000.

Non-taxation of allowances for volunteer firefighters

Volunteer firefighters may receive up to $500 per year in non-taxable allowances.

The estimates are based on census data.

Northern residents deductions

Individuals living in prescribed areas in Canada for a specified period may claim the northern residents deductions. The benefits consist of a residency deduction of up to $15 a day, a deduction for two employer-provided vacation trips per year, and unlimited employer-provided medical travel. Residents of the Northern Zone are eligible for full benefits, while residents of the Intermediate Zone are eligible for 50 per cent of the benefits.

The current definition of prescribed areas came into force in 1991. However, the implementation of the current system was gradual. Certain communities, which had qualified under the pre-1991 regime but are no longer eligible under

the current system, received full benefits until 1992, two-thirds benefits in 1993, one-third benefits in 1994, and zero benefits thereafter. Communities in the Intermediate Zone which had qualified under the pre-1991 regime received full benefits until 1992, two-thirds benefits in 1993, and 50-per-cent benefits thereafter.

Overseas employment credit

A tax credit is available to Canadian employees working abroad for more than six months in connection with certain resource, construction, installation, agricultural or engineering projects. The credit is equal to the tax otherwise payable on 80 per cent of the employee's net overseas employment income taxable in Canada (up to a maximum income of $80,000).

Employee stock options

Provided certain conditions are met, the benefits provided by employee stock options (ESOs) are taxed at a preferential rate. A deduction equal to one-quarter the value of the benefit from the ESO is available to offset the tax liability on the option.

For Canadian-controlled private corporations (CCPCs), the benefits accruing from ESOs are not included in income until the disposition of shares acquired with the options. However, the shares must be held for a minimum of two years to qualify for the one-quarter deduction. For non-CCPCs, the benefit provided by an ESO must be included in income when the option is exercised.

Estimates presented in the table reflect the one-quarter deduction, but not the benefit from the deferred inclusion of benefits accruing under ESOs.

Non-taxation of strike pay

Strike pay is non-taxable.

Statistics Canada has ceased collecting information on the amount of strike pay.

Deferral of salary through leave of absence/sabbatical plans

Employees may be entitled to defer salaries through a leave of absence/ sabbatical plan. Provided certain conditions are met by the plan, these amounts are not subject to tax until received.

No data are available.

Employee benefit plans

In certain circumstances, employers may make contributions to an "employee benefit plan" on behalf of their employees. The employee is not required to include in income the contributions to the plan or the investment income

earned within the plan until amounts are received. Employers may not deduct these contributions to the plan until these contributions are actually distributed to the employees.

No data are available.

Non-taxation of certain non-monetary employment benefits

Fringe benefits provided to employees by their employers are not taxed when it is not administratively feasible to determine the value of the benefit. Examples include merchandise discounts, subsidized recreational facilities offered to all employees and special clothing.

No data are available.

Family

Spousal credit

A taxpayer supporting a spouse is entitled to a tax credit of 17 per cent of $5,380. This credit is reduced by 17 per cent of the amount by which the dependent spouse's income exceeds $538.

Effective with the 1993 taxation year, the definition of spouse for tax purposes has been expanded to include common-law spouses, provided that the couple has lived together at least one year or has a common child.

Equivalent-to-spouse credit

An "equivalent-to-spouse" tax credit may be claimed in respect of a dependent child under age 18 or a parent or grandparent by taxpayers without a spouse. The amount of the credit and the limitation on the dependant's income are the same as for the spousal credit.

Dependant credit

Taxpayers can claim the dependant credit for dependent relations over 17 years of age who were physically or mentally infirm. For taxation years prior to 1996, the credit was 17 per cent of $1,583 for dependants whose income was below $2,690. The credit was reduced by 17 per cent of the dependant's net income in excess of that amount and was exhausted when the dependant's net income exceeded $4,273.

Effective in the 1996 taxation year, the amount on which the credit is based is $2,353 and the credit begins to be phased out at $4,103.

Refundable child tax credit

In 1992, individuals receiving family allowances were entitled to an income-tested refundable child tax credit. The basic amount was $601 per child. A supplement of $213 was available to each child under the age of seven.

This supplement was reduced by 25 per cent of all child care expenses deducted. The combined credit was reduced by 5 per cent of the amount of parents' net income in excess of $25,921.

The credit for dependants under the age of 18 was eliminated with the introduction of the child tax benefit in 1993.

Child Tax Benefit

The child tax benefit (CTB) was introduced in 1993, replacing the family allowance, the dependant credit for children under 18 years of age and the refundable child tax credit. The child tax benefit payments are made monthly and are non-taxable.

The child tax benefit provides a basic credit of $1,020 per child annually, plus $75 for the third and each subsequent child. It also includes a supplement of $213 for each child under age seven, the total of which is reduced by 25 per cent of the child care expenses claimed. The total benefit is reduced by 5 per cent (2.5 per cent for one-child families) of family net income over $25,921.

The child tax benefit also includes a working income supplement for low-income working families. Until July 1, 1997, the working income supplement (WIS) is equal to 8 per cent of the family earned income in excess of $3,750, reaching a maximum supplement of $500 at $10,000 of family earned income. The WIS is reduced by 10 per cent of the family net income in excess of $20,921.

The 1996 budget announced a two-step increase in the WIS, adding $125 million in July 1997 and an additional $125 million in July 1998. The 1997 budget proposed to enrich and restructure the WIS by providing benefits for each child, instead of a single benefit per family. The maximum benefit will be increased from $500 per family to $605 for a first child, $405 for a second child and an additional $330 for the third and each subsequent child. The WIS will continue to be phased in at annual family earnings of $3,750, reaching a maximum at $10,000 of family earned income. The WIS will be reduced by 12.1 per cent of net family income in excess of $20,921 for one-child families, 20.2 per cent for a two-child family and 26.8 per cent for families with three or more children.

This change will enrich the WIS by $195 million in July 1997, $70 million more than the $125 million announced for July 1997 in the 1996 budget. The CTB will be enriched further by $600 million and simplified to become the Canada Child Tax Benefit starting July 1, 1998, as part of a federal-provincial-territorial initiative to create a National Child Benefit System.

Deferral of capital gains through transfer to spouse

Individuals may transfer capital property to their spouses or spousal trusts at the adjusted cost base of the property rather than the fair market value. This provides a deferral of the capital gain until the subsequent disposition of the property or until the transferee spouse dies.

Property transferred to other family members or to unrelated individuals (or to trusts of which they are beneficiaries) is treated differently from interspousal transfers. The transferor is generally deemed to have disposed of the property at the time of transfer at fair market value and must include any resulting capital gain in income at that time.

In case of property transferred to a trust (other than a spousal trust), capital gains are generally considered to be realized at the time of the transfer on the basis of the fair market value of the property at that time. In addition, trusts are generally subject to a deemed realization of assets every 21 years at the fair market value. The 21-year deemed realization was deferred for certain electing trusts. However, the 1995 budget eliminated this election and prevents any deferral of the 21-year realization beyond January 1, 1999.

No data are available.

Farming and Fishing

$500,000 lifetime capital gains exemption for farm property

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified farm property and qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption (where applicable) and the $500,000 lifetime capital gain exemption on small business shares have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Net Income Stabilization Account (NISA)

Farmers may deposit a percentage of a given year's eligible net sales, up to a limit, to their Net Income Stabilization Account. No tax deduction is given in respect of these deposits. Some of the deposits are matchable by the federal and provincial governments. Governments also pay a 3-per-cent interest bonus annually on the farmer's deposits which remain in the account. Governments' contributions and interest accrued in the account are not taxable until withdrawn. All withdrawals from the NISA are taxable except for the contributor's original deposits, which were made with after-tax dollars. Withdrawals from the NISA are triggered if the current year gross margin (net sales less eligible expenses) is less than the average gross margin from previous years (up to five), or if net income is below $10,000 (or $20,000 of family net income if the family held only one account).

The federal tax expenditure is a function of two components: the deferral of tax on the investment income accrued in the account and on government contributions to the account; and the income inclusion of these amounts when withdrawn from the account. The former has the effect of increasing tax expenditures, while the latter has the opposite effect. The estimates provided in the table are made on a current cash-flow basis. That is, they measure the impact on revenues of the tax measure in each of the years under consideration.

Deferral of income from destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

The estimates are based on data provided by Agriculture Canada.

Deferral of income on grain sold through cash purchase tickets

Under the cash purchase ticket program of the Canadian Wheat Board, farmers may make deliveries of grain before the year end and receive payment in the form of a ticket that may be cashed in subsequent years. The payment is included in income only when the ticket is cashed.

The estimates are based on data provided by the Canadian Wheat Board.

Deferral through 10-year capital gain reserve

If proceeds from a sale of a farm property to a child, grandchild or great-grandchild are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year, creating a maximum 10-year reserve period. For most other assets, the maximum reserve period is five years.

Deferral of capital gain through intergenerational roll-overs of family farms

Sales or gifts of assets to children, grandchildren or great-grandchildren typically give rise to taxable capital gains to the extent that the fair market value exceeds the adjusted cost base of the property. However, capital gains on intergenerational transfers of farm property are deferred until the property is disposed of outside the immediate family.

No data are available.

Exemption from making quarterly tax instalments

Taxpayers earning business income must normally pay quarterly income tax instalments. However, individuals engaged in farming and fishing pay two-thirds of their estimated tax payable at the end of the taxation year and the remainder on or before April 30 of the following year.

No data are available.

Cash basis accounting

Individuals engaged in farming and fishing may elect to include revenues when received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income inclusion and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues, and expenses are deductible for the period to which they relate.

No data are available.

Flexibility in inventory accounting

Farmers using the cash basis method of accounting are allowed to depart from it with regard to their inventory. Under cash accounting, net additions to inventory are treated as a cost which is deducted in computing income. When inventory is increasing from year to year, such costs could create a loss for tax purposes. However, a discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farmers to avoid creating losses which would be subject to the time limitation if carried forward. The value of the tax expenditure is thus the amount of tax relief associated with the losses that would otherwise have been subject to the time limitations.

No data are available.

Federal-Provincial Financing Arrangements

Quebec abatement

Under the contracting-out arrangements which were offered to provinces in the mid-1960s for certain federal transfer programs, provinces could elect to receive part of the federal contribution in the form of a tax point transfer. Quebec was the only province to elect this arrangement at the time and this has resulted in a 16.5 percentage-point abatement of federal tax for Quebec residents.

Transfers of income tax room to provinces

In 1967, the federal government transferred tax points to all provinces in place of certain direct cash transfers under the cost-shared program for post-secondary education. As a result, the personal income tax abatement was increased by 4 percentage points. In 1977, an additional 9.5 percentage points of individual income tax were provided to the provinces in respect of post-secondary, hospital insurance and medicare programs.

General Business and Investment

$100,000 lifetime capital gains exemption

The 1994 budget eliminated the $100,000 lifetime capital gains exemption (LCGE) for gains accrued after February 22, 1994. Unrealized gains accrued prior to that date were grandfathered. Individuals who had not disposed of their assets on that date were allowed to elect to claim the $100,000 LCGE on their 1994 tax return for gains accrued up to February 22, 1994. They were deemed to have disposed of their assets for an amount not exceeding their fair market value on that date.

The $100,000 LCGE applied in taxation years 1992 and 1993 and in 1994 for capital gains realized before February 22, 1994. The LCGE allowed individuals to exempt up to $100,000 in realized capital gains over their lifetime. The exemption was available only to the extent that the gains exceeded cumulative net investment losses incurred after 1987. The costs of tax expenditures associated with capital gains realized on exempt qualified farm property and exempt qualified small business shares are listed separately, even though some of these gains would qualify for the $100,000 lifetime capital gains exemption.

The 1992 budget eliminated the exemption for real estate gains accruing after February 1992 on property not used in an active business.

Partial inclusion of capital gains

Only three-quarters of net realized capital gains are included in income.

Deduction of limited partnership losses

A limited partner is able to deduct losses against other income up to the amount of investment at risk whereas a shareholder is normally not permitted to deduct corporate losses against personal income. Unused losses may be carried back three years or forward seven years and are deductible up to the amount of investment at risk.

Limited partnership losses arise from a range of investments, from real estate investments to certified film productions. It is estimated that 15 per cent of this tax expenditure for years before 1995 is attributable to CCA claimed on Canadian films.

Investment tax credit

A tax credit is available for investments in scientific research and experimental development, exploration activities and certain regions. The tax credits range from 15 per cent to 45 per cent. The estimates treat the full investment tax credit as a tax expenditure even though tax credits reduce the capital cost of assets for CCA purposes and the adjusted cost base for capital gains purposes. A more detailed explanation is provided in Chapter 4.

Deferral through five-year reserve

If proceeds from a sale of capital property are not all receivable in the year of the sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds are received. A minimum of 20 per cent of the gain must be brought into income each year, creating a maximum five-year reserve period.

Deferral through capital gains roll-overs

In certain circumstances, taxpayers may defer the reporting of capital gains for tax purposes. General business roll-over provisions may be categorized into three groups:

Involuntary dispositions

Capital gains resulting from an involuntary disposition (e.g., insurance proceeds received for an asset destroyed in a fire) may be deferred if the funds are reinvested in a replacement asset within a specified period. The capital gain is taxable upon disposition of the replacement property.

Voluntary dispositions

Capital gains resulting from the voluntary disposition of land and buildings by businesses may be deferred if replacement properties are purchased soon thereafter (for example, a business changing location). The roll-over is generally not available for properties used to generate rental income.

Transfers to a corporation for consideration including shares

Individuals may transfer an asset to a corporation controlled by them or their spouses and elect to roll over any resulting capital gain or recaptured depreciation into the corporation instead of paying tax in the year of sale.

No data are available.

Deferral through billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

Deduction of accelerated tax depreciation

The depreciation allowable for tax purposes is called capital cost allowance (CCA). It may differ from true economic depreciation. A tax deferral may thus be created when the tax deductions in the early years of the life of an asset

exceed the actual depreciation in the value of the asset. The difference is captured upon subsequent disposition of the asset.

The methodology for estimating this tax expenditure is explained in Chapter 4.

$1,000 capital gains exemption on personal-use property

Personal-use property is held primarily for the use and enjoyment of the owner rather than as an investment.

In calculating the capital gain on personal-use property, if the proceeds of disposition are less than $1,000, no capital gain needs to be reported. If the proceeds exceed this amount, the adjusted cost base (ACB) will be deemed to be a minimum of $1,000, thus reducing the capital gain in situations where the true ACB is less than $1,000.

No data are available.

$200 capital gains exemption on foreign exchange transactions

The first $200 of net capital gains on foreign exchange transactions is exempt from tax.

No data are available.

Taxation of capital gains upon realization

Capital gains are taxed upon the disposition of property and not when they accrue. This provides a tax deferral.

No data are available.

Health

Non-taxation of employer-paid insurance benefits for group private health and dental plans

Employer-paid benefits for private health and dental plans are not taxable.

The estimates are based on data from Statistics Canada and from an annual survey "Health Insurance Benefits in Canada", conducted by the Canadian Life and Health Insurance Association.

Disability credit

Canadians who are markedly restricted in the basic activities of daily living are entitled to a tax credit. The credit is 17 per cent of $4,233. Any unused amount of the credit may be transferred to a supporting person.

Medical expense credit

Taxpayers are entitled to a 17-per-cent credit for eligible medical expenses incurred by the taxpayer, the taxpayer's spouse or by dependants. The credit is available in respect of expenses which exceed the lesser of 3 per cent of net income or $1,614.

Medical expense supplement for earners

The 1997 budget proposed the creation of a refundable medical expense credit for low-income working Canadians with high medical expenses.

The new refundable credit will supplement the assistance that is provided through the existing medical expense tax credit. The maximum refundable credit will be the lesser of $500 and 25 per cent of eligible medical expenses. It will be available to those individuals earning over $2,500, and will be reduced by 5 per cent of net family income in excess of $16,069.

Income maintenance and retirement

The non-taxation of income-tested programs such as the guaranteed income supplement and provincial social assistance presents conceptual difficulties. The problems arise because, in many respects, these programs operate like an income tax in that eligibility for benefits is phased out after a certain income level. In this regard, excluding such benefits from income tax might not be considered a tax expenditure since they are subject to their own "tax". On the other hand, a broadly based benchmark tax system would include such amounts in income. Given the comprehensive approach taken in this document, these items are considered to be tax expenditures.

Non-taxation of guaranteed income supplement and spouse's allowance benefits

The guaranteed income supplement (GIS) is an income-tested benefit payable to old age security (OAS) pensioners. Spouses of OAS recipients (or widows/widowers) aged between 60 and 64 may be eligible for the spouse's allowance (SPA). Benefits under both the guaranteed income supplement and spouse's allowance programs are non-taxable. Although GIS and SPA benefits must be included in income, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on data from Human Resources Development Canada and the personal income tax simulation model.

Non-taxation of social assistance benefits

Social assistance benefits received by low-income Canadians must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such benefits from taxation while continuing to have them affect income-tested credits.

The estimates are based on the personal income tax simulation model and data provided by Human Resources Development Canada.

Non-taxation of workers' compensation benefits

Workers' compensation benefits must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such benefits from taxation while continuing to have them affect income-tested credits.

Non-taxation of certain amounts received as damages in respect of personal injury or death

Amounts received in respect of damages for personal injury or death, and awards paid pursuant to the authority of criminal-injury compensation laws are not taxable. In addition, investment income earned on personal injury awards is excluded from income until the end of the year in which the person reaches the age of 21.

The values reported in Table 1 understate the tax expenditure since they are based on awards paid by provincial Criminal Injuries Compensation Boards only. No data were available for compensation awards paid by other sources, or regarding the investment income earned on awards by individuals under age 22.

Non-taxation of employer-paid premiums for group term life insurance of up to $25,000

Employer-paid premiums for group term life insurance coverage of up to $25,000 per employee paid before July 1, 1994 were not taxable.

The 1994 budget eliminated the tax exemption, effective July 1, 1994.

Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)

These amounts are not included in income for tax purposes.

The estimates are based on public accounts data.

Non-taxation of veterans' disability pensions and support for dependants

These amounts are not included in income for tax purposes.

The estimates for this item are based on public accounts data.

Treatment of alimony and maintenance payments

Until April 30, 1997, payments by a taxpayer to a divorced or separated spouse were deductible to the payer and taxable in the hands of the recipient.

This treatment represents a tax expenditure because it departs from the benchmark system established for purposes of this report. Under this benchmark tax system, deductions are permitted only for expenses incurred in order to earn income and amounts received from other individuals are not included in the income of the recipient.

As of May 1, 1997, child support paid pursuant to a written agreement or court order made on or after that day will not be deductible to the payer nor included in the income of the recipient. Child support paid pursuant to a court order or written agreement made before that date will continue to be deductible to the payer and included in the income of the recipient, unless the agreement is varied. The tax changes do not apply to spousal support. Spousal support payments will remain deductible by the payer and included in the income of the recipient.

Age credit

Prior to 1994, individual taxpayers aged 65 or over were entitled to claim a tax credit of up to 17 per cent of $3,482. Starting in 1994, the age credit became subject to an income test. The age amount was reduced by 7½ per cent of net income in excess of $25,921 in 1994, and by 15 per cent for 1995 and subsequent years. Unused portions may be transferred to a spouse.

Pension income credit

A 17-per-cent tax credit is available on up to $1,000 of certain pension income. The unused portion of the credit may be transferred to a spouse.

Saskatchewan pension credit

Contributions to the Saskatchewan Pension Plan are deductible up to the lesser of $600 or the amount of unused RRSP room in a particular year.

Registered pension plans/registered retirement savings plans

The federal revenue foregone due to the provisions pertaining to registered retirement savings plans (RRSPs), registered pension plans (RPPs) and deferred profit-sharing plans (DPSPs) is a function of three components: the deductibility of contributions to such plans; the non-taxation of investment income accrued within such plans; and the income inclusion of RPP/RRSP withdrawals which reduces the cost resulting from the previous two. Individuals benefit from a deferral of tax on amounts contributed and on investment income. Also, there is an absolute tax saving to the extent that the tax rate on withdrawals is below that faced at the time of contributions. As noted in Chapter 1, the estimates provided in the table are made on a current cash-flow basis – that is, they measure the impact on revenues of the tax measure in each of the years under consideration.

In 1991, a new system of comprehensive limits on tax-assisted retirement saving took effect. Under this system, saving in RRSPs, RPPs and DPSPs is governed by a comprehensive limit of 18 per cent of earnings up to a dollar amount. In more detail, the limits are as follows:

- For defined benefit pension plans, there are no fixed limits on employee contributions while employer contributions are restricted to the amounts necessary to fully fund the promised benefits. Annual pension benefits under these pension plans are limited to the lesser of $1,722 and 2 per cent of earnings for each year of pensionable service.
- For RRSPs, contributions are limited to 18 per cent of earned income for the preceding taxation year up to a dollar maximum ($12,500 for 1993, $13,500 for 1994, $14,500 for 1995, $13,500 from 1996 to 2003), minus a Pension Adjustment (PA). The PA is based on RPP or DPSP benefits earned by plan members in the previous taxation year. For a money purchase RPP or a DPSP, the PA is simply the total contribution made by, or on behalf of, a plan member in the year. For a defined benefit RPP, the PA is a measure of the benefits earned in the year, calculated according to a prescribed formula.

In 1992, the federal government introduced the Home Buyers' Plan as a temporary measure. It allowed all individuals to withdraw up to $20,000 from their RRSPs on a tax-free basis to purchase a home. Amounts withdrawn under the Home Buyers' Plan are to be repaid to the individual's RRSP on an interest-free basis over a period of 15 years. Amounts that are not repaid are included in the individual's income for tax purposes. (In 1994, this measure was made permanent, but restricted to first-time home buyers only.) The impact of the Home Buyers' plan on the cost of RRSPs is expected to be small.

It should be noted that the RRSP/RPP estimates do not reflect a mature system because contributions currently exceed withdrawals. Assuming a constant tax rate, if contributions equalled withdrawals, only the non-taxation of investment income would contribute to the net cost of the tax expenditure. As time goes by and more retired individuals have had the opportunity to contribute to RRSPs throughout their lifetime, the gap between contributions and withdrawals will shrink and possibly even become negative. The upward bias in the current cash-flow estimates can therefore be expected to decline.

The estimates may not reflect the benefit to a particular individual in any given year because the individual is typically either a contributor or withdrawer at a point in time but not both. In order to estimate the benefit to a particular individual, one could calculate the difference in disposable income between a situation in which that individual invests in an RRSP/RPP and one in which that individual invests in a non-sheltered savings instrument.

Data used to estimate the value of these measures were taken from the personal income tax model, unpublished data from Statistics Canada, and from Statistics Canada publications *Trusteed Pension Funds* (Cat. 74-201) and *Pension Plans in Canada* (Cat. 74-401), as well as from the *Bank of Canada Review*.

Deferred profit-sharing plans

Employers may make tax-deductible contributions to a profit-sharing plan on behalf of their employees. These amounts are taxable in the hands of the employees when withdrawals are made from the plan. The employer's contribution cannot exceed one-half of the money purchase RPP dollar limit for the year ($6,750 in 1993 and $7,250 in 1994 to 2003) or 18 per cent of the employees earnings. The amount is included in the PA for the taxpayer. The taxpayer's total PA (for both RPP and DPSP contributions) cannot exceed the money purchase RPP dollar limit for the year ($13,500 for 1993 and $14,500 for 1994 to 2003).

No data are available.

Non-taxation of RCMP pension/compensation in respect of injury, disability or death

Pension payments and other compensation received in respect of an injury, disability or death associated with service in the Royal Canadian Mounted Police are non-taxable.

No data are available.

Non-taxation of up to $10,000 of death benefits

Up to $10,000 of death benefits paid by an employer to the spouse of a deceased employee is non-taxable.

No data are available.

Non-taxation of investment income on life insurance policies

The investment income earned on some life insurance policies is not taxed as income to the policyholder. Instead, for reasons of administrative convenience, insurance companies are subject to tax on such earnings.

(See Chapter 4 for a further description of this measure and estimates of the cost of the tax expenditure involved.)

Small Business

$500,000 lifetime capital gains exemption for small business shares

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption (where applicable) and the $500,000 lifetime capital gain exemption on qualified farm property have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Deduction of allowable business investment losses

Under the benchmark system, capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, three-quarters of capital losses in respect of shares or debts of a small business corporation (allowable business investment losses) may be used to offset other income. Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

The estimated tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year. The tax expenditure is overestimated since it does not reflect the future reduction in tax revenues that would occur if those losses were instead deducted from future capital gains.

Labour-sponsored venture capital corporations' credit

A tax credit is provided to individuals for the acquisition of shares of labour-sponsored venture capital corporations. For shares acquired before March 6, 1996, the rate of the credit was 20 per cent to a maximum credit of $1,000. For shares acquired after March 5, 1996, the rate of the tax credit is 15 per cent, to a maximum credit of $525.

Deferral through 10-year capital gain reserve

If proceeds from the sale of small business shares to children, grandchildren or great-grandchildren are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year creating a maximum 10-year reserve period. This contrasts with the treatment of most other property where the maximum reserve period is five years.

Other Items

Non-taxation of capital gains on principal residences

Capital gains realized on the disposition of a taxpayer's principal residence are non-taxable. The capital gains were determined using multiple listing service (MLS) housing prices, adjusted to include expenditures on capital repairs and major additions and renovations, obtained from Statistics Canada's *Consumer Expenditure Survey*. The holding period for principal residences was derived from 1981 census data.

Estimates for this item are provided for both partial and full inclusion rates for capital gains.

Non-taxation of income from the Office of the Governor General

This income is exempt from personal income taxation.

Data were provided by the Office of the Governor General.

Assistance for prospectors and grubstakers

Where a prospector or grubstaker disposes of mining property to a corporation in exchange for shares in that corporation, the tax liability is deferred until the subsequent disposition of the shares. At that time, only three-quarters of the amount for which the mining property was transferred to the corporation need be included in income.

Charitable donations credit

Donations of up to 50 per cent of net income (20 per cent prior to 1996) made to registered charities qualify for the charitable donations credit in the year. Donations in excess of the limit may be carried forward for up to five years. The percentage of income restriction does not apply to certain gifts of cultural property. The credit is 17 per cent on the first $200 ($250 in 1992 and 1993) of total donations (including gifts to the Crown) and 29 per cent on donations in excess of $200 ($250 in 1992 and 1993).

Beginning in 1995, donations of ecologically sensitive lands were exempted from the net income limit. Beginning in 1996, the limit on donations in the year of death and the preceding year was raised to 100 per cent, and the general limit of 50 per cent was further increased by half the amount of taxable capital gains resulting from the donation of appreciated capital property.

The 1997 budget proposes to further increase the limit to 75 per cent of net income plus 25 per cent of the amount of taxable capital gains arising from the donations of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property.

Reduced inclusion rate for capital gains arising from certain charitable donations

The 1997 budget proposes to reduce the inclusion rate on capital gains arising from certain donations by individuals or corporations to charities (other than private charitable foundations) from 75 per cent to 37½ per cent. Donations that would be eligible would be those of securities that are listed publicly on a recognized stock exchange in Canada, where the donation is made between February 18, 1997 and the end of the year 2001.

Gifts to the Crown credit

A tax credit is available for gifts to the Crown. The credit is 17 per cent on the first $200 ($250 in 1992 and 1993) of total donations (including charitable donations) and 29 per cent on donations in excess of $200 ($250 in 1992 and 1993). Unused contributions may be carried forward for up to five years.

Beginning in 1995, donations of ecologically sensitive land were exempted from the net income limit. The 1997 budget proposes to restrict gifts to the Crown to 75 per cent of net income plus 25 per cent of the amount of taxable capital gains arising from the donation of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property. The limit would not apply to gifts in the year of death and the preceding year, gifts of ecologically sensitive land and certain gifts of cultural property.

Political contribution credit

A credit is available for donations to registered federal political parties. The credit is 75 per cent of the first $100 of contributions, 50 per cent on the next $450 of contributions and 33⅓ per cent on the next $600. The maximum credit claimable in any year is $500.

Non-taxation of income of Indians on reserves

Section 87 of the *Indian Act* exempts the personal property of a status Indian and Indian bands from taxation if such personal property is situated on a reserve. Courts have held that the term "personal property" includes income. Determining whether income is situated on reserve requires an examination of the factors that connect it to a reserve. With respect to employment income, for example, a key factor is the location (on or off a reserve) at which the employment duties were performed.

No data are available.

Non-taxation of gifts and bequests

Gifts and bequests are not included in the income of the recipient for tax purposes.

No data are available.

Memorandum Items

Non-taxation of lottery and gambling winnings

Lottery and gambling winnings are excluded from income for tax purposes.

The estimate for the non-taxation of winnings in government lotteries is based on information provided by Statistics Canada. Values for the non-taxation of winnings from horse-racing are estimated using data provided by Agriculture Canada. The values do not include winnings from other types of gambling, such as bingo and casino winnings where no accurate data are available.

The estimate assumes that the total amount of lottery and horse-racing winnings would be included in income and subject to tax. However, there is some uncertainty regarding the proper benchmark tax system in this case. If lottery winnings were taxable, for example, there would be an argument for

allowing a deduction for the purchase cost of tickets. There would be a large administrative cost in taxing thousands of small prizes, in particular instant win lotteries, and so a threshold below which winnings would not be taxable would be necessary. Therefore, taxing lottery winnings could result in substantially lower revenues than the figure published in this report.

In addition, a federal tax on lottery winnings would raise significant federal-provincial issues since this is an area which the federal government has agreed to vacate in favour of the provinces. It could be argued that taxing lotteries breaches that agreement. Proceeds from the sale of lottery tickets are an important source of funds for provincial governments. As a result, there is already an element of taxation to lottery and gambling proceeds. This item is therefore included as a memorandum item.

Non-taxation of allowances for certain public officials

Members of Parliament (MPs), Members of a Legislative Assembly (MLAs), Senators and some other public officials (such as elected municipal officials and judges) receive flat allowances for expenses incidental to their duties. These amounts are not included in income for tax purposes.

This provision is a memorandum item because it is not possible to distinguish the proportion of these allowances which is used for personal consumption and that which is for work-related expenses.

Data are available only for the non-taxable allowances provided to MPs, MLAs and Senators. This information is found in the publications *Canadian Legislatures* and *The Canadian Parliamentary Guide*.

Non-taxation of allowances for diplomats and other government employees posted abroad

Diplomats and other government employees posted abroad receive an allowance to cover the additional costs associated with living outside Canada. These allowances are not taxable.

Information on total allowances was obtained from Treasury Board.

Child care expense deduction

Child care expenses incurred for the purpose of earning business or employment income, taking an occupational training course or carrying on research for which a grant is received are deductible, up to a limit. The deduction cannot exceed the lesser of $5,000 per child if the child is under age seven or is disabled plus $3,000 per child between seven and 16 years of age (14 years before 1995); two-thirds of earned income for the year; and the actual amount of child care expenses incurred. Beginning in 1995, the two-thirds earned income limit does not apply to single parent students. The deduction must generally be claimed by the spouse with the lower income. However, the higher-income parent may claim a deduction if the lower-income parent is infirm, confined to a bed or a wheelchair, in prison, or attending a designated educational institution on a full-time basis.

Attendant care expense deduction

A disabled individual can deduct the cost of unreimbursed care provided by a part-time attendant, if such an expense is required to enable the individual to work. For taxation years 1992 to 1997, the deduction cannot exceed the lesser of $5,000 and two-thirds of earned income for the year. The 1997 budget proposes to eliminate the limit on attendant care expenses.

Moving expense deduction

All reasonable moving expenses incurred to earn employment or self-employment income at a new location (e.g., transportation, meals and temporary accommodation, cost of selling a former residence) are deductible from earnings or business income received after the move if the taxpayer moves at least 40 kilometres closer to the new place of employment or study. The deduction has to be claimed in the year, or in the following year if it exceeds earnings at the new location in the year of the move. Moving expense reimbursements provided by employers are not included in income.

The estimates do not include non-taxable reimbursements received from employers.

Deduction of carrying charges incurred to earn income

Interest and other carrying charges, such as investment counselling fees and safety deposit box charges, incurred to earn business or investment income are deductible.

Some might consider the deductibility of such expenses to be a tax expenditure because of the tax deferral arising from the upfront deduction of expenses associated with the earning of income which will not be taxed until received possibly in future years. Others would hold that carrying charges are incurred for the purpose of earning income and therefore represent part of the benchmark income tax system.

Deduction of meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 50 per cent of the cost of food, beverages and entertainment (80 per cent before February 22, 1994). Where the cost of food, beverages or entertainment is part of a package price which includes amounts not subject to the 50-per-cent limitation – for instance the fee for a conference – the taxpayer is required to determine the value or make a reasonable estimate of the amount subject to the 50-per-cent limitation.

Deduction of farm losses for part-time farmers

Individuals whose major source of income is not farming are allowed to deduct farm losses against other income up to an annual maximum of $8,750.

Part-time farm losses that are not deductible in the current year may be carried back three years and forward 10 years to deduct against farm or non-farm income. The estimates include the cost of these carry-overs.

Farm and fishing loss carry-overs

Farm and fishing losses may be carried back three years and forward 10 years. Most other business losses may be carried forward only seven years.

The only data that are available are prior years' losses carried forward to the current year. In this regard, the estimates do not include current year losses carried forward or back to other taxation years, nor do they include future losses carried back to the taxation year in question. The estimates do not include losses carried over by part-time farmers.

Capital loss carry-overs

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. The estimates do not include current year losses carried forward or back to other taxation years nor do they include future losses carried back to the taxation year in question.

Non-capital loss carry-overs

Non-capital losses may be carried back three years and forward seven years to offset other income.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost estimates may understate the true amount of revenue foregone because they do not include current year losses carried forward or back to other taxation years nor do they include future losses carried back to the taxation year in question.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of two-thirds of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province.

The estimates are based on data from Revenue Canada.

Deduction of resource-related expenditures

Individuals are entitled to deduct certain expenses associated with the exploration for, and development of, Canadian natural resources. These expenses are deductible if the taxpayer either engages directly in these resource activities or provides financing to a resource company which, in turn, "flows through" the tax deductions to the taxpayer.

A tax expenditure arises when a flow-through share investor is able to use deductions for exploration and development more quickly than would otherwise have been possible by the resource company that actually undertook these expenditures. This may be because the taxpayer has otherwise-taxable income in a year and the corporate issuer of the flow-through does not. It may also be the direct result of a special provision for junior oil and gas companies whereby expenses that would otherwise be deductible at 30 per cent can be deducted at 100 per cent when "flowed through" using flow-through shares.

However, the available data do not permit a separation of expenses that are flowed through to investors and those that are incurred directly by the taxpayers. Accordingly, only some portion of resource-related expenditures deducted represents a true tax expenditure. Consequently, the total cost of all these deductions has been calculated, but these amounts are treated as a memorandum item.

Deduction of other employment expenses

Employee expenses are generally not deductible. However, specific employment expenses (e.g., automobile expenses, cost of meals and lodging for certain transport employees, legal expenses paid to collect salary) are deductible in certain circumstances in the computation of income.

This provision is a memorandum item because it is not possible to distinguish the proportion of these expenses which is used for personal consumption and that which is incurred in order to earn income.

Deduction of union and professional dues

Union and professional dues are fully deductible from income.

The mandatory nature of these payments leads to their classification as expenses to earn income.

Employment insurance contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for employment insurance contributions. Employer-paid premiums are not included in the employee's income.

The mandatory nature of employment insurance contributions leads to their classification as expenses incurred to earn income.

Canada and Quebec Pension Plan contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for Canada/Quebec Pension Plan (CPP/QPP) contributions by both employees and the self-employed. Employer-paid premiums are not included in the employee's income.

Again, since CPP/QPP contributions are mandatory, they are classified as expenses incurred to earn income.

Foreign tax credit

In order to avoid double taxation, a tax credit is provided in recognition of income taxes paid in foreign countries.

Dividend gross-up and credit

Dividends received from taxable Canadian corporations are "grossed up" by a factor of one-quarter and included in income. A tax credit equal to 13.33 per cent of the grossed-up amount is then provided, in recognition of taxes paid at the corporate level. These provisions contribute to the integration of the corporate and personal income tax systems.

Basic personal credit

All taxpayers qualify for a basic personal credit equal to 17 per cent of $6,456.

Non-taxation of capital dividends

Private corporations may distribute the exempt one-quarter of any realized capital gains accumulated in their "capital dividend account" to their shareholders in the form of a capital dividend. This dividend is non-taxable. This measure is reported as a memorandum item since it contributes to the integration of the taxation of corporate and personal income.

No data are available.

Chapter 4

Description of Corporate Income Tax Provisions

The descriptions of the specific tax measures contained in this chapter are intended as a simplified reference and are not detailed descriptions of specific tax measures.

Many of the estimates and projections are provided using the corporate income tax micro-simulation model, which has been developed jointly with Revenue Canada.

Tax Rate Reductions

The following items are measures that reduce the statutory tax rate faced by a corporation. They are considered to be tax expenditures because income is taxed at a rate other than the generally applicable tax rate.

Low tax rate for small businesses

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for a small business tax rate reduction, known as the small business deduction. This deduction lowers the basic federal tax rate on the first $200,000 of active business income of CCPCs by 16 percentage points – from 28 per cent to 12 per cent.

The 1994 budget announced changes that make some larger CCPCs ineligible for the small business deduction. Effective July 1, 1994, CCPCs with more than $15 million of taxable capital employed in Canada are no longer eligible for this rate reduction. In addition, CCPCs with between $10 million and $15 million of taxable capital employed in Canada have reduced access to the small business deduction.

Low tax rate for manufacturing and processing

A tax reduction is provided on Canadian manufacturing and processing (M&P) income not subject to the small business deduction. This reduction takes the form of a non-refundable tax credit and has the effect of lowering the tax rate on M&P income. In the period under review, the effective reductions from the general 28-per-cent rate were as follows:

For that portion of a corporation's taxation year between

July 1, 1990 – June 30, 1991:	4 percentage points
July 1, 1991 – December 31, 1992:	5 percentage points
January 1, 1993 – December 31, 1993:	6 percentage points
January 1, 1994 – present:	7 percentage points

As a result, since 1994, Canadian manufacturing and processing income has been effectively taxed at a federal rate of 21 per cent, a seven-percentage-point reduction from the general rate.

The tax expenditure is estimated as the additional revenue that would have been collected by the government if M&P income had been taxed at the general corporate income tax rate.

Low tax rate for credit unions

Although not a private corporation for most purposes, a credit union is eligible for the small business deduction (i.e. 16 per cent of its taxable income). A credit union with more than $200,000 of active business income may be eligible for a deduction of 16 per cent of its taxable income where the total income of the corporation since 1971 is less than the corporation's "maximum cumulative reserve", which is equal to 5 per cent of amounts owing to members (including members' deposits and share capital). The purpose of this additional deduction is to permit a credit union to accumulate capital on a tax-preferred basis up to a maximum of 5 per cent of deposits and capital.

Exemption from branch tax for transportation, communication, banking and iron ore mining corporations

The branch tax is imposed on that portion of the income of non-Canadian corporations derived from the carrying on of business in Canada through a branch. The rate is 25 per cent, but this is frequently reduced by bilateral tax treaties to 15 per cent, 10 per cent or 5 per cent.

A corporation is exempt from the branch tax if it is:

- a bank;
- a corporation whose principal business is:
  - the transportation of persons or goods,
  - communications, or
  - mining iron ore in Canada; or
- an exempt corporation such as a registered charity.

No data are available.

Exemption from tax for international banking centres

A prescribed financial institution's branch or office carrying on certain business in the cities of Montreal or Vancouver may qualify as an international banking centre (IBC) and therefore be exempt from tax on its income. To qualify as an IBC under the *Income Tax Act*, the branch's income must be derived from accepting deposits and making loans to non-residents. This measure,

introduced in 1987, is considered a tax expenditure because a financial institution can undertake business with non-residents through a Canadian permanent establishment without being subject to Canadian income taxes.

No data are available.

Tax Credits

Investment tax credits

The following measures are credits against federal income taxes otherwise payable. They are considered to be tax expenditures because they provide incentives to certain taxpayers which invest in certain activities, such as scientific research and experimental development (SR&ED), or in certain capital assets in designated regions of the country.

The amount of an investment tax credit (ITC) is calculated as a percentage of the cost of eligible expenditures. ITCs can reduce federal income tax revenues in one of two ways. They may be:

- used to offset federal income taxes otherwise payable; or
- fully or partially refunded in the year they are incurred in the case of smaller CCPCs.

Prior to 1994, there was a limitation on the amount of ITCs that could be utilized in a taxation year. Specifically, in most cases, ITCs could only be used to offset up to 75 per cent of a taxpayer's federal income tax and surtax otherwise payable. For CCPCs, a special rule permitted the full offset of federal tax on their business income eligible for the small business deduction. The annual ITC limitation had been introduced to reduce the number of large corporations that were profitable, but did not pay income tax. However, as announced in the 1993 budget, the introduction of the large corporations tax eliminated the need for the annual ITC limitation and investment tax credits became fully deductible for all taxpayers for taxation years beginning after 1993.

Certain ITCs earned in a year may be refunded to individuals and qualifying corporations that cannot use them to reduce federal income taxes otherwise payable. The rate of refundability for these ITCs is generally 40 per cent. However, a qualifying CCPC may receive a refund of 100 per cent on SR&ED ITCs earned at the 35-per-cent rate in respect of up to $2 million of eligible current expenditures.

For 1992 and 1993, a qualifying corporation for purposes of the refund was generally a CCPC with taxable income not exceeding $200,000 in the preceding year. However, the 1993 budget modified this rule in the case of the SR&ED ITC so that, after 1993, refundability phases out as the prior-year taxable income of a CCPC (or associated corporate group) rises above $200,000 and is eliminated entirely at $400,000. This change was made to

reduce the negative consequences of exceeding the $200,000 limit by even a small amount, thereby easing the transition between the start-up phase and the period of expansion that small businesses typically experience, and providing more certainty to their business planning. In order to focus ITC benefits to smaller CCPCs, the 1994 budget introduced a further change to phase out refundability after 1995 for CCPCs with taxable capital employed in Canada between $10 million and $15 million.

All refunds reduce the amount of ITC for carry-over purposes. Unused ITCs may be carried forward 10 years or back three years.

ITCs utilized or refunded in a year reduce either the undepreciated capital cost of the asset for capital cost allowance (CCA) purposes or, in the case of SR&ED, the SR&ED pool. Credits earned in respect of a property acquired after 1989, and not immediately available for use may not become claimable or refundable until the property is available for use or has been held by the taxpayer for two years.

Issues in calculating the value of ITCs

To maintain consistency with the other estimates in this document, the amounts reported in the table estimate the foregone revenue for the year in question from each ITC. In other words, the estimates show how much additional revenue would have been collected by the government in the year if the ITC had been eliminated in that particular year. To do this, the amount of ITCs used in the year are separated into two components: ITCs that were both earned and used in the year, and ITCs that were earned in prior years, but carried forward and used in the year. The former represents credits in respect of current year expenditures. The costs of any applicable refunds of ITCs earned are included in these estimates. The latter item – ITCs earned in past years but not used until the current year – is itemized separately as an aggregate for all ITCs.

Another perspective on the revenue cost of each ITC may be obtained by looking at the amount of ITCs earned in a specific year. This information is provided in the following table for 1992 and 1993. However, it should be recognized that ITCs earned in the year are not necessarily used in the year – they may be used in a subsequent or previous year, subject to the carry-over rules. As a result, had the ITCs been eliminated, government revenues for the year would not have been higher by the amounts shown in the following table since it may take a number of years for ITCs earned in a year to be used by the taxpayer to reduce federal taxes.

Investment tax credits earned in the year

	1992*	1993
	($ millions)	
SR&ED ITC	1,250	1,352
Atlantic ITC	151	124
Special ITC	21	48
Cape Breton ITC	3	S
Small business ITC	5	228

* These 1992 figures are based on final data and may differ from the figures in last year's edition of this document which were based on preliminary data.

SR&ED investment tax credit

There were three rates of SR&ED ITC prior to 1995: a general rate of 20 per cent; an enhanced rate of 35 per cent for CCPCs with prior-year taxable income of less than $200,000; and a rate of 30 per cent for the Atlantic provinces and Gaspé region. The latter rate was eliminated in the 1994 budget effective after 1994. The maximum amount of SR&ED expenditures that can earn ITCs at the 35-per-cent rate in a year is $2 million.

The SR&ED ITC is earned on eligible current and capital expenditures in respect of SR&ED in Canada performed by, or on behalf of, a taxpayer and related to a business of the taxpayer.

Atlantic investment tax credit

Prior to 1995, the Atlantic investment tax credit (AITC) was available at a rate of 15 per cent in respect of eligible expenditures in the Atlantic region – i.e. Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, the Gaspé region and their associated offshore areas. The 1994 budget reduced the AITC rate to 10 per cent for eligible expenditures incurred after 1994.

The AITC is earned on eligible expenditures on new buildings, machinery and equipment employed in the following qualifying activities: farming, fishing, logging, mining, oil and gas, and manufacturing and processing.

The AITC is refundable at a rate of 40 per cent for qualifying CCPCs and individuals.

Special investment tax credit

Prior to 1995, the special investment tax credit (SITC) was provided at a rate of 30 per cent for eligible expenditures on new buildings, machinery and equipment used in qualifying activities in qualifying regions of Canada. The SITC was eliminated in the 1994 budget, effective January 1, 1995. However, certain activities in the Atlantic region continue to be eligible for the AITC.

Qualifying activities were defined under the *Regional Development Incentives Act* and its regulations, and generally included manufacturing and processing facilities located in a qualifying region with the exception of certain primary processing of natural resources.

Qualifying regions included north-eastern British Columbia, north-western Alberta, northern Saskatchewan, most of Manitoba, northern Ontario, northern Quebec and the Gaspé region, and areas of Atlantic Canada.

Cape Breton investment tax credit

The Cape Breton investment tax credit was applicable to eligible expenditures on new buildings, machinery and equipment acquired for use in qualifying activities in Cape Breton after May 23, 1985 and before 1993. The original rate of 60 per cent was reduced to 45 per cent after 1988.

Small business investment tax credit

The small business investment tax credit was available at a rate of 10 per cent for eligible expenditures on machinery and equipment acquired after December 2, 1992 and before 1994 by unincorporated businesses, partnerships and CCPCs, other than those subject to the large corporations tax. The credit was not refundable.

ITCs claimed in current year but earned in prior years

These are tax credits that were earned by corporations in previous years but not claimed until the current year. There is a revenue cost to the government when the credits are used by corporations to reduce federal taxes payable. While the aggregate amount of these credits is known with some confidence, there is not enough information available to identify separately the amounts for each credit.

Political contribution tax credit

A non-refundable tax credit is available for contributions to registered federal political parties or candidates. The credit is earned at a rate of 75 per cent on the first $100 contributed, 50 per cent on the next $450 contributed and 33⅓ per cent on the next $600 contributed. The maximum credit is $500 and is available when the taxpayer has contributed $1,150.

This measure constitutes a tax expenditure because political contributions are not incurred to earn income.

Exemptions and Deductions

The following exemptions and deductions are considered tax expenditures because they deviate from the benchmark tax system.

Partial inclusion of capital gains

Three-quarters of net realized capital gains are included in income. The amount of the tax expenditure is the additional tax that would have been collected had the remaining one-quarter of the capital gains been included in income. However, this amount is likely an overestimate of the true amount of this tax expenditure. To the extent that the capital gains are from shares that

have increased in value due to retained earnings, and which have already been taxed at the corporate level, the partial inclusion of the capital gains provides some relief from double taxation and, therefore, should be part of the benchmark tax system.

The 1997 budget proposes to reduce the inclusion rate on capital gains arising from certain donations to charities (other than private charitable foundations) from 75 per cent to 37½ per cent. Donations that would be eligible would be those of securities that are listed publicly on a recognized stock exchange in Canada, where the donation is made between February 18, 1997 and the end of the year 2001.

Royalties and mining taxes

Non-deductibility of Crown royalties and mining taxes

The current tax system does not permit a deduction for Crown royalties or mining taxes. The deduction has been denied since May 6, 1974. From that time to the end of 1975, oil and gas and mining companies were eligible for a resource tax abatement which provided a lower rate of tax on oil and gas and mining income. A resource allowance (discussed below) was introduced in the June 1975 budget and replaced the resource tax abatement after 1975.

A negative tax expenditure is calculated for the non-deductibility of Crown royalties and mining taxes. A negative tax expenditure implies that the government collects more income taxes than would have otherwise occurred in the benchmark system. The issue arises as to whether the benchmark tax system would include a deduction for all Crown royalties and mining taxes. Two generic types of non-deductible Crown charges are levied on the extraction of natural resources. One type is a simple royalty system where the Crown charge is based only on gross revenues. There are also more complex systems of Crown charges that are based on net resource profits – i.e. resource profits after the deduction of numerous costs, including capital, operating costs and sometimes a return on capital employed.

In the case of Crown charges based on gross revenues, the benchmark system would include a deduction for these royalties since they are analogous to costs of production. However, the benchmark tax system would not include a deduction for the latter type of profit-related Crown royalties and mining taxes because they are structured more like income taxes. Provincial income taxes are not considered to be a deductible expense in the benchmark system. Provincial payroll and capital taxes, on the other hand, are deductible and they are not treated as tax expenditures.

The calculations shown here represent the federal corporate income tax revenues generated by the current rules which deny the deductibility of all Crown royalties and mining taxes. No attempt has been made to divide the disallowed royalties into the two categories described above. This is, in part, due to the fact that many royalty systems include characteristics of both a gross and net calculation. Thus, the calculation represents an overestimate of the actual negative tax expenditure.

Resource allowance

Since 1976, the income tax system has provided a resource allowance equal to 25 per cent of a taxpayer's annual resource profits, computed after operating costs and capital cost allowances, but before the deduction of exploration expenses, development expenses, earned depletion and interest expenses. The resource allowance is provided in lieu of the deductibility of Crown royalties, mining taxes and other charges related to oil and gas or mining production. The measure allows the provinces room to impose royalties or mining taxes on the production of natural resources while maintaining the integrity of the federal income tax base. For analytical purposes, the value of the tax expenditure for the royalties and mining taxes is broken down into two components:

- the federal tax revenue earned by disallowing royalty deductibility (a negative tax expenditure, described above); and
- the federal tax revenue foregone resulting from allowing 25 per cent of resource profits to be deductible for tax purposes (a positive tax expenditure).

An approximation of the overall impact of the resource allowance measure (compared to the benchmark tax system) can be obtained by netting the two above effects.

The 1996 budget announced changes to clarify and tighten the rules for the resource allowance, including:

- clarifications in amounts that must be deducted in computing the resource allowance; and
- other measures to minimize tax avoidance – for example, new rules on partnerships, transactions between non-arm's-length parties and the treatment of service income.

Earned depletion

Earned depletion is an additional deduction from taxable income of certain exploration and development expenditures and other resource investments. Prior to 1990, taxpayers were entitled to earn an extra deduction of up to 33⅓ per cent of most exploration and development expenses or the costs of assets related to new mines or major expansions. The deductions for earned depletion are generally limited to 25 per cent of the taxpayer's annual resource profits although mining exploration depletion can be deducted against non-resource income. As in the case of a Canadian exploration expense or a Canadian development expense, earned depletion could be pooled (i.e. placed in a special account, and any remaining balance could be carried forward indefinitely for use in later years).

Additions to the depletion pools for earned depletion and mining exploration depletion were eliminated as of January 1, 1990. Deductions can still be made on the basis of existing depletion pools.

Under the benchmark tax system, a deduction for earned depletion would not be available.

Deductibility of charitable donations

Donations made by corporations to registered charities are deductible in computing taxable income. For years prior to 1996, this deduction is limited to 20 per cent of net income. Unused deductions may be carried forward for up to five years.

The 1996 budget announced that, for 1996, the deduction limit would be raised to 50 per cent of net income plus 50 per cent of taxable capital gains resulting from the donation of property. The 1997 budget proposes to further increase the limit to 75 per cent of net income plus 25 per cent of the amount of taxable capital gains arising from the donation of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Gifts to the Crown

A corporation may deduct the full amount of any gift it makes to Canada or a province. Prior to 1997, unlike charitable donations, the amount deductible is not limited to 20 per cent of net income. However, the deduction could not exceed the amount of income in a particular fiscal year. Amounts not deducted can be carried forward for up to five years. The 1997 budget proposes to restrict gifts to the Crown to 75 per cent of net income plus 25 per cent of the amount of taxable capital gains arising from the donation of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property. The limit would not apply to gifts of ecologically sensitive land and certain gifts of cultural property.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Non-deductibility of advertising expenses in foreign media

Expenses for advertising in non-Canadian newspapers or periodicals or on non-Canadian broadcast media cannot generally be deducted for income tax purposes if they are directed primarily to a market in Canada. Deducting the cost of advertising in foreign periodicals or on television stations is not restricted if the advertising is to promote sales in foreign markets.

This treatment results in a negative tax expenditure since the deduction of an expense incurred to earn income is denied. Under the benchmark tax system, advertising expenses in foreign media incurred to gain or produce income from a business or property would be deductible whether targeted at foreign or domestic markets.

No data are available.

Non-taxation of provincial assistance for venture investments in small business

Government assistance received by a corporation is normally either included in the corporation's income or reduces the cost basis of the assets to which the assistance relates for CCA purposes. There are a number of exceptions to this rule, including provincial assistance provided for venture capital investment under specified provincial programs. Under the benchmark tax system, this type of assistance would be included in the corporation's income or would reduce the cost basis of the related assets.

No data are available.

Deferrals

The tax expenditures in this section provide for a deferral of income taxes from the current to a later taxation year. They have been valued on a cash-flow basis (i.e. the foregone tax revenue associated with the additional net deferral in the year). The alternative way of valuing deferrals would be to calculate the value of the interest-free loan that is provided to the taxpayer when taxes are deferred to a later year.

Accelerated write-off of capital assets and resource-related expenditures

Under the benchmark tax system, corporations would be permitted a deduction for the use of capital assets based on economic depreciation rates. Using the cash-flow approach, the tax expenditure would be the foregone revenue resulting from the difference between the deduction for tax purposes, usually CCA, and economic depreciation.

This approach can provide some indication of the tax expenditure resulting from the accelerated deductions, the magnitude of which will depend on the growth rate of investment. If the growth rate was zero, then, in the long run, no tax expenditure amount would be calculated. Because economic depreciation is difficult to determine, the deductions for capital assets reported by companies in their financial statements are often used as a substitute. However, financial statement depreciation may differ from economic depreciation. Furthermore, not all companies classify the capital asset deductions as depreciation or some other readily identifiable expense. For example, in the leasing industry, a lease may be classified as an operating lease for tax purposes with capital cost allowance being claimed, while for accounting purposes, it may be classified as a capital lease, in which case the corresponding accounting deduction may not be specifically identifiable. Since the costs written off for financial statement purposes for this sector cannot be precisely determined, it is not possible to estimate the related tax expenditure. More generally, adequate data are not available to calculate with any degree of accuracy this tax expenditure.

Even if adequate data were available, there are instances when differences between the deductions for tax purposes and economic depreciation would not accurately reflect the tax expenditure. First, it should be noted that the accelerated deductions for tax purposes lead only to a deferral, not a permanent reduction, of tax payable. If CCA rates are higher than actual depreciation rates, then during the initial years, the CCA claim would exceed economic or financial statement depreciation. However, in later taxation years, the reverse would occur (i.e. actual depreciation would exceed the amount allowed for tax purposes). These differences between CCA and actual depreciation would lead to a positive tax expenditure in the early years of asset ownership since higher CCA rates in the initial years are a tax incentive. However, in later years, the CCA claim would be less than actual depreciation resulting in a negative tax expenditure, thus offsetting the previous tax expenditure to some extent.

In addition, because CCA is a discretionary deduction, the cash-flow method could result in a tax expenditure being reported even if there is no acceleration of CCA rates (i.e. a tax expenditure may be reported even though the CCA rates corresponded with those used in financial statements). A company may claim less than the maximum amount in a particular year. As a result, in that year, the cash-flow method would result in a negative tax expenditure. Because the company would now have a larger undepreciated balance for tax purposes, future CCA write-offs would be larger than the corresponding financial statement expense, thereby resulting in a positive tax expenditure in future years.

Finally, differences between CCA and financial statement deductions may also result from the treatment of dispositions. For tax purposes, assets are grouped in pools with gains or losses on disposition adjusting the undepreciated balance while, for financial statement purposes, gains and losses are often recognized on an asset-by-asset basis. Also, the asset cost for tax purposes may differ from the cost for financial statement purposes in that, for accounting purposes, interest costs are often capitalized while, for tax purposes, such costs are generally expensed in the year incurred.

Although it is not possible to estimate with any degree of accuracy the expenditure using the cash-flow approach, some indication of the magnitude of the tax expenditure relating to a particular accelerated write-off provision can be calculated by comparing the estimated discounted present value of the tax benefits resulting from acquisitions in a particular year under each of the two depreciation methods. For example, if the CCA rate is higher than the actual depreciation rate, the discounted present value of the benefit of being able to claim CCA would exceed the discounted present value of the benefit of the financial statement depreciation, thereby resulting in a measure of the positive tax expenditure or tax incentive that has been provided.

The number of asset classes with accelerated depreciation rates was reduced significantly when changes were introduced in 1988. As a result, many CCA rates now approximate the rate of economic or financial statement depreciation and the associated tax expenditure related to accelerated depreciation provisions has been reduced. However, a few instances remain where the CCA rates are clearly accelerated – that is, the tax system allows a larger deduction from income for the first few years after the property is acquired than is applied for financial statement purposes. The more significant of these accelerated CCA provisions are described below along with illustrations of the net present value of the benefit of some of the remaining accelerated CCA provisions.

Vessels (class 7)

Vessels are generally included in class 7 and are subject to a maximum CCA rate of 15 per cent on a declining balance basis. Accelerated CCA on a straight-line basis at a maximum rate of 33⅓ per cent of the capital cost of the property is available in respect of a vessel, including furniture, fittings, radio communication equipment and other equipment if it was (a) constructed in Canada, (b) registered in Canada, and (c) not used for any purpose whatever before acquisition by the owner. These assets are depreciated over a four-year period, with 16⅔ per cent written off in the first and fourth years, and 33⅓ per cent written off in the second and third years.

Railway assets (classes 35, 1 and 3)

Railway cars are generally included in class 35 and depreciated at a rate of 7 per cent on a declining balance basis. However, some railway cars are eligible for additional allowances. Railway cars acquired after December 6, 1991 by common carriers are eligible for an additional allowance of 3 per cent. Railway cars for rent or lease are generally eligible for an additional allowance of 6 per cent.

Other railway property such as track, grading, control or signalling equipment, is generally included in class 1 and subject to a 4-per-cent declining-balance rate. Certain railway property acquired after December 6, 1991, that is included in class 1, is eligible for an additional allowance of 6 per cent.

Railway trestles are generally included in class 3 and subject to a 5-per-cent declining-balance rate. Certain trestles acquired after December 6, 1991 are eligible for an additional allowance of 5 per cent.

These additional allowances generally raise the CCA rates on certain railway cars, track and other railway equipment acquired after December 6, 1991, to 10 per cent. The half-year rule applies.

Energy-efficient equipment (classes 34 and 43.1)

Prior to the changes announced in the 1994 budget, straight-line depreciation of 25 per cent, 50 per cent and 25 per cent was applicable to certain equipment used for the generation of electricity or the production or distribution of heat. Qualifying equipment includes equipment designed to: produce heat derived primarily from the consumption of wood wastes or municipal wastes; produce electrical energy by using wind energy; or recover heat that is a by-product of an industrial process. Also included as qualifying equipment are: hydro-electric installations not exceeding 15 megawatts; certain types of co-generation equipment; and certain types of active solar heating equipment.

The changes announced in the 1994 budget effectively terminated additions to class 34 after February 21, 1994, and redefined eligibility criteria. Many of the assets that had been eligible for class 34 became eligible for a reduced depreciation rate of 30 per cent on a declining balance basis under class 43.1.

Class 43.1 was introduced following the termination of class 34. Eligibility for class 43.1 is described in draft regulations to the *Income Tax Act*. In general, the following types of equipment may qualify for inclusion in class 43.1: co-generation and specified waste-fueled electrical generation systems; active solar systems; small-scale hydroelectric installations; heat recovery systems; wind energy conversion systems; photovoltaic electrical generation systems; geothermal electrical generation systems; and specified waste-fueled heat production equipment. Active solar systems, heat recovery systems and waste-fueled heat production equipment must be used directly in connection with an industrial process to qualify as class 43.1 equipment.

Class 43.1 is also subject to the "specified energy property" rules which may reduce the amounts that can be deducted to less than 30 per cent of the unclaimed capital cost.

Water and air pollution control property (classes 24 and 27)

Assets which are acquired primarily for the purposes of abating water or air pollution at a site are included in class 24 or class 27, respectively. These assets are eligible for three-year straight-line CCA of 25 per cent, 50 per cent and 25 per cent. The water and air pollution control equipment must be new property that is used in operations that were started before 1974 and have been continuously carried on since that time. The 1994 budget announced that additions to these classes will be terminated after 1998.

Mining

Certain mining buildings, machinery and equipment acquired for use at a new mine or a major expansion of an existing mine may qualify for an accelerated CCA rate of up to 100 per cent. A 25-per-cent increase in a mine's capacity is generally considered to be a major expansion.

These mining assets were previously included in class 28 and depreciated at a rate of 30 per cent. For acquisitions after 1987, these assets are included in class 41, and depreciated at a rate of 25 per cent. In addition to the 25-per-cent allowance provided in class 41, a taxpayer owning such property and operating the mine may claim an additional allowance equal to the lesser of (1) the remaining undepreciated capital cost of property of the class, or (2) the income for the year from the new or expanded mine.

The 1996 budget announced income tax changes for oil sands projects. The objective of the changes was to provide a more equitable tax treatment for the two different oil sands extraction methods (mining and *in situ*). Mining methods involve the removal of overburden and the transportation of bituminous sands to a central processing facility where the oil (bitumen) is separated from the sand using hot water. With *in situ* operations, the oil is recovered from an underground reservoir by the application of heat or other techniques which make the oil more mobile and capable of flowing from a well or wells.

The 1996 budget extended the accelerated CCA rules to the eligible depreciable capital costs for *in situ* projects. The tax treatment that previously had been available only for new mines (both mineral and oil sands) and major mine expansions was also extended to other capital investments, including large incremental capital costs for efficiency improvements and environmental purposes. Specifically, all tangible capital expenditures incurred for all types of mines, including oil sands projects, would qualify for accelerated CCA to the extent that, in a year, these capital costs exceeded 5 per cent of gross revenue from that mine or oil sands project in that year.

Exploration costs

Expenditures incurred in determining the existence, location, extent or quality of mineral resources, and oil or gas, or incurred to develop mineral resources prior to commercial production in Canada are classified as a Canadian exploration expense (CEE) and deducted for tax purposes at a rate of 100 per cent.

Generally accepted accounting principles allow companies to depreciate exploration expenditures on either a “full cost” or a “successful efforts” basis. The full cost method requires that all exploration costs, whether they result in new production or not, be capitalized and amortized as the reserves are depleted. The successful efforts method requires that only those costs which result in the discovery of reserves and which have a benefit in terms of future revenues are capitalized; other costs are expensed as incurred. Most Canadian-controlled companies follow the full cost method, while foreign-controlled companies in Canada usually follow the successful efforts method.

The 100-per-cent write-off of CEE for tax purposes is more rapid than the amounts used for financial statement purposes especially for successful exploration. The fast write-off for CEE provides a deferral of tax.

Under the benchmark tax system, corporations would be permitted an immediate deduction only for unsuccessful exploration expenditures. However, those costs associated with successful exploratory activities (i.e. those costs that result in producing assets for both the mining and oil and gas sectors) would be permitted a deduction based on an amortization over the life of the asset.

Under certain conditions, corporations entering into flow-through share agreements are entitled to reclassify limited amounts of a Canadian development expense (normally a 30 per cent deduction on a declining balance basis) into a Canadian exploration expense. The tax expenditure associated with this provision is calculated as a personal tax expenditure item since these deductions are taken by the purchasers of the flow-through shares which are generally individuals.

Capital equipment used for SR&ED

Eligible capital expenditures for the provision of premises, facilities or equipment used for SR&ED in Canada may be fully deducted in the year they are incurred. In the absence of this provision, these amounts would have been depreciable over several years. Under the benchmark tax system, expenditures that are capital in nature and designed to produce income in the future are depreciated over a period approximating that during which the income is expected to arise.

Illustration

Assuming a taxable corporation makes a $100,000 investment in an eligible asset, the net present value of the income tax reduction resulting from accelerated CCA is presented in the following table. This illustration is based upon a federal corporate income tax rate of 29.12 per cent and uses a discount rate of 8 per cent. The actual net present value of the reduced federal tax resulting from accelerated CCA will vary depending upon the tax status of the corporation, its effective tax rate, and the amount of CCA actually claimed in future years. The following table presents the maximum value of the incentive assuming that firms can fully benefit from the accelerated CCA. The one exception is for the analysis of mining assets (see table footnote).

	CCA Class	Accelerated rate	Baseline tax depreciation rate	Net present value of reduced federal tax resulting from accelerated CCA
Vessels	7	33⅓% straight-line	15% declining balance	$5,800
Railway cars	35	10% declining balance	7% declining balance	$2,500
Electrical generating equipment using wind, solar and geothermal energy	43.1	30% declining balance	4% declining balance	$12,800
Energy efficient equipment used in manufacturing and processing (pre1994 budget)	34	50% straight-line	30% declining balance	$2,900
Water and air pollution control property	24 and 27	50% straight-line	30% declining balance	$2,900
Mining assets				
Oil sands and *in situ* oil	28 and 41	100% (subject to income restriction)	25% declining balance	$500 to $4,000*
Conventional mines	28 and 41	100% (subject to income restriction)	25% declining balance	$500 to $1,300*
Scientific research and experimental development equipment	Full write-off in year	Full write-off in year	30% declining balance	$4,800
Exploration costs	Full write-off in year	Full write-off in year	30% declining balance	$4,800

* The estimates are based on existing oil sands mining projects and typical oil recovery projects using *in situ* methods as obtained from industry sources. For conventional mines, the analysis was based on hypothetical mine models developed by Natural Resources Canada. These latter mine models include a range of low and high profitability metal mines. The net present value of the federal tax varies according to the ability of a project to accelerate its CCA deductions. This ability depends *inter alia* on prices for oil/minerals.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income.

Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to a capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted against uncertain taxable capital gains in the future.

Holdback on progress payments to contractors

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g., 10 to 15 per cent) is often held back until the entire project is completed satisfactorily. The amount held back need not be brought into the income of the contractor until the project to which it applies is certified as complete, rather than when earned as would be required in the benchmark tax structure. Where a contractor, in turn, withholds an amount from a subcontractor, costs equal to the amount of the holdback are not considered to have been incurred by the contractor and are not deductible until paid. The net impact of these two measures on a given contractor's tax liability depends on the ratio of holdbacks payable to holdbacks receivable. If holdbacks receivable are greater than holdbacks payable, there is a deferral of tax. If holdbacks payable exceed holdbacks receivable, there is a prepayment of taxes.

Increases in net holdbacks receivable or decreases in net holdbacks payable result in a positive estimate of the amount of the tax expenditure. Increases in net holdbacks payable or decreases in net holdbacks receivable result in a negative estimate.

Available for use

Before 1990, taxpayers were allowed to claim CCA and ITCs in respect of property not yet producing income (i.e. property not in use). In many cases, this resulted in a significant mismatch of revenues and expenses which gave rise to a tax deferral. This was a tax expenditure because taxpayers were allowed to claim deductions and tax credits on property before it was put in use.

As of 1990, taxpayers may claim CCA and ITCs on eligible property at the earlier of the time it is put in use or in the second taxation year following the year of acquisition. Property that became eligible for CCA and ITCs by virtue of the two-year deferral rule could give rise to a tax deferral (and this would constitute a tax expenditure).

No data are available as assets are pooled into classes and are not accounted for separately. Furthermore, assets are not identified as being "available for use" or "not available for use".

Capital gains taxation on realization basis

Capital gains are taxed upon the disposition of property and not on an accrual basis. This treatment results in a tax deferral. Furthermore, certain roll-over mechanisms such as share-for-share exchange provisions extend the period of tax deferral. Under the benchmark tax system, capital gains would be fully included in income as they accrue.

No data are available.

Expensing of advertising costs

Advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future. Under the benchmark tax system, the expenses would be amortized over the benefit period. While the benefits of advertising may extend beyond the current year, measuring that benefit is not feasible.

No data are available.

Cash basis accounting

Farming and fishing corporations may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues.

No data are available.

Flexibility in inventory accounting

Farm corporations using the cash basis method of accounting are allowed to depart from it with regard to their inventory. A discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farm corporations to avoid creating losses which, if carried forward, would be subject to the time limitation. Thus the tax expenditure provides tax relief to the extent that the losses would otherwise have been subject to the time limitations.

No data are available.

Deferral of income

On grain sales

Farmers may make deliveries of grain before the year end and be paid with a ticket that may be cashed only in the following year. The payment for deliveries of grain is included in income only when the ticket is cashed, thereby providing a deferral of taxes. Under the benchmark tax system, income would be taxed on an accrual basis.

No data are available.

On destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxed on an accrual basis.

No data are available.

Deferral of tax from use of billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. However, in computing their income for tax purposes, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

International

Non-taxation of life insurance companies' world income

All Canadian corporations except Canadian multinational life insurers are taxed on their worldwide income. Canadian multinational life insurers are taxed only on their profits from carrying on a life insurance business in Canada using special rules in the income tax regulations.

The cost of this tax expenditure was estimated from tax returns and information available from the Office of the Superintendent of Financial Institutions. However, information from the Office of the Superintendent of Financial Institutions is not available after 1992.

Exemptions from non-resident withholding tax

Canada, like other countries, imposes a withholding tax on various types of income paid to non-residents. The basis for this tax rests on the internationally accepted principle that a country has the right to tax income that arises or has its source in that country. The types of income subject to non-resident withholding tax include: certain interest, dividends, rents, royalties and similar payments; management fees; estate and trust income, alimony and support payments; as well as certain pension, annuity and other payments.

Over time, as the benefits of freer trade in capital, goods and services have been increasingly recognized, countries including Canada have adjusted their tariff and tax structures to remove impediments to international transactions. Part of this adjustment has been the reduction of non-resident withholding tax on certain payments.

Canada's statutory non-resident withholding tax rate is 25 per cent. However, the rate is lowered and exemptions provided for certain payments through an extensive network of bilateral tax treaties. These rate reductions, which apply on a reciprocal basis, differ depending on the type of income and the tax treaty country.

The *Income Tax Act* also provides for a number of unilateral exemptions from withholding tax including: exemptions for interest payments on government debt; interest payments to arm's-length persons on long-term corporate debt; interest payments to arm's-length persons on foreign currency deposits with branches of Schedule I banks; and royalty payments for the use of copyright.

Lower withholding taxes can reduce the cost to Canadian business of accessing capital and other business inputs from abroad. For example, a lower Canadian withholding tax on interest payments to non-residents can reduce the cost of accessing foreign capital in cases where foreign creditors raise the interest rate charged to cover payment for withholding tax. Similarly, a reduced withholding tax on royalty payments can reduce the cost of accessing foreign technology and other property and services, and thereby enhance the competitiveness of Canadian businesses requiring these inputs.

The estimates of the tax expenditures associated with withholding tax exemptions for certain royalties, interest, dividends and management fees paid to non-residents were derived from a detailed analysis of payments to non-residents and withholding tax collections on those payments for 1992, 1993 and 1994, and projections of payments to non-residents over the post-1994 period. The cost estimates were derived by applying treaty withholding tax rates (in the case of payments to a country with which Canada had a tax treaty in the year considered) or the statutory 25-per-cent withholding tax rate (in the case of payments to non-treaty countries), that would otherwise apply in the absence of an exemption, to observed and projected payments data under the benchmark assumption used throughout this publication of no behavioural response to the hypothetical removal of existing withholding tax exemptions.

This benchmark assumption of no behavioural response is particularly difficult to sustain for this type of tax. Foreign providers of capital, technology and other property and services, in most cases, are unwilling to bear the withholding tax given that they do not pay such a tax when supplying other markets. If a withholding tax was to be imposed, foreign providers would either require that the tax be shifted back to the Canadian borrower or user of property or services in the form of higher charges (which in many cases could not be absorbed), or they would bypass Canada in favour of other foreign markets where such a tax does not exist, again implying increased financing and other business costs to Canadians. Indeed, these same competitiveness considerations have led to the introduction of a number of withholding tax exemptions both in Canada and in other countries.

Thus, these particular tax expenditure estimates cannot be interpreted as additional revenues that could be collected from non-residents if the withholding tax exemptions were removed, since the removal of the exemptions would generally involve the elimination of the tax base.

Exemption of income earned by foreign ship and aircraft companies from Canadian income tax

Non-resident persons operating a ship in international traffic are exempted from Canadian income tax. Similarly, non-resident persons operating an airline in international traffic are exempted from Canadian income tax. In both cases, the exemption applies only if the non-resident's home country gives Canadian residents substantially similar tax relief. The amount of the tax expenditure is the tax that would otherwise be payable on profits related to the Canadian business of the non-resident persons, net of the tax collected on the non-Canadian income of the resident persons.

No data are available.

Other Tax Expenditures

Transfer of income tax room to provinces in respect of shared programs

In 1967, federal-provincial fiscal arrangements were altered. The federal government substituted a transfer of corporate income tax points for direct transfers to provinces under the cost-shared program for post-secondary education. The tax change involved an increase in the corporate income tax abatement rate from 9 to 10 percentage points, effectively reducing the federal corporate income tax rate at that time from 37 per cent to 36 per cent (the rate before the abatement was 46 per cent). This transfer of tax room has been included as a tax expenditure because it is a substitute for direct spending programs.

Interest credited to life insurance policies

Life insurance companies are taxed under the investment income tax (IIT) at a rate of 15 per cent on net investment earnings attributable to life insurance policies.

The IIT interacts with the taxation of policyholders. The *Income Tax Act* divides life insurance policies into two categories: savings-oriented policies and protection-oriented policies.

Savings-oriented policies are those where the amount of money invested in the policy is large relative to the death benefit. A holder of a savings-oriented policy is subject to annual accrual taxation in respect of the net investment earnings credited to the policy. Net investment earnings reported by these holders are subtracted from the IIT base in order to avoid double taxation of net investment earnings.

In contrast, a holder of a protection-oriented policy is not subject to annual accrual taxation. Net investment earnings are taxed when the policy is surrendered or terminated (other than by death), or when paid out as policy dividends once the cumulative dividends exceed the total premiums paid under the policy. Net investment earnings that are taxable to holders of protection-oriented policies are also deductible from the IIT base.

Most of the cost of the tax expenditure relates to protection-oriented policies. This cost has three basic elements:

- differences between personal and IIT rates;
- timing differences (i.e. policies that are eventually taxed in the hands of policyholders); and
- permanent differences (i.e. policies that are held until the death of the insured).

Non-taxation of registered charities and other non-profit organizations

Registered charities and other non-profit organizations, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the charity or organization has taxable income, mainly investment income or profits from certain commercial activities.

No data are available.

Income tax exemption for provincial and municipal corporations

Provincial Crown corporations and municipal corporations are exempt from income tax. Under the benchmark tax structure, such corporations would be taxable to the extent that they had taxable income.

No data are available.

Non-taxation of certain federal Crown corporations

While federal Crown corporations are generally not subject to income tax, those Crown corporations that carry on significant commercial activities are taxable. It is possible, however, that some exempt corporations have income that would be taxable under the benchmark tax system.

No data are available.

Excise tax transportation rebate

The excise tax transportation rebate, introduced in 1991 and effective for the 1991 and 1992 calendar years, allowed transportation businesses to receive an excise tax rebate of 3 cents for each litre of eligible fuel on which federal fuel excise tax of 4 cents per litre was paid. In exchange, businesses that elected to receive this rebate were required to reduce their income tax losses by 10 dollars for every one dollar rebated. This provided the industry with an immediate cash-flow benefit at the cost of lower loss carry-forwards to offset income taxes in future years.

This rebate was applicable to purchases of diesel and aviation fuel subject to federal excise tax during the 1991 and 1992 calendar years.

A simpler option was available for trucking businesses that could elect to receive a rebate of 1½ cents per litre up to a maximum of $500 per taxpayer in lieu of the 3-cent-per-litre rebate.

Aviation fuel excise tax rebate

The government has recently announced a program to provide excise tax rebates on the aviation fuel used by airline companies. Rebates will be limited to $20 million per year per associated group of companies. In order to receive a rebate, a company must agree to reduce its income tax losses by 10 dollars for every one dollar of rebate.

Surtax on the profits of tobacco manufacturers

Tobacco manufacturers are subject to a special surtax on their profits. The surtax is levied at a rate of 40 per cent of the Part I tax on tobacco manufacturing profits. The surtax was originally announced as part of the National Action Plan to Combat Smuggling in February 1994. In November 1996, the government announced that the surtax would be extended for an additional three years to February 2000.

The surtax is considered a tax expenditure because it constitutes a departure from the benchmark system. Because the surtax results in more revenues than would otherwise be raised under the benchmark tax system, it is a negative tax expenditure.

Temporary tax on the capital of large deposit-taking institutions

The temporary surcharge is levied at a rate of 12 per cent of the financial institution capital tax imposed under Part VI of the *Income Tax Act* calculated before any credit for income taxes and as if there was a capital deduction of $400 million. The surcharge applies to financial institutions as defined under Part VI, but not to life insurance companies. The surcharge is not eligible to be offset by tax payable under Part I.

The surcharge was introduced in the 1995 budget for a period of 18 months; extended for one year in the 1996 budget; and extended for another year in the 1997 budget. The surcharge is now scheduled to expire after October 31, 1998.

The surcharge is considered a tax expenditure because it constitutes a departure from the benchmark system. Because the surcharge results in more revenues than would otherwise be raised under the benchmark tax system, it represents a negative tax expenditure.

Memorandum Items

Refundable Part I tax on investment income of private corporations

This and the following item are parts of the tax system that provide some integration between the personal and corporate tax systems. Their values are calculated as additional corporate taxes that would be owing if corporations and individuals were treated as separate tax units.

A portion of the income taxes paid on investment income received by a private corporation (excluding deductible inter-corporate dividends) is refunded to a CCPC when this income is paid out to shareholders as dividends.

Prior to June 30, 1995, a corporation's refundable tax equalled approximately 20 percentage points of the Part I tax paid on its investment income. To further ensure the integration of corporate and individual income taxes, an additional refundable tax of 6⅔ per cent is levied on the investment income received after June 30, 1995 by a CCPC. This additional tax is refunded to a private corporation, along with refundable Part I tax, when the investment income is paid to shareholders as dividends. Corporations receive a refund from their refundable tax account at a rate of one dollar for every three dollars of taxable dividends paid.

Refundable capital gains for special investment corporations

Capital gains realized by an investment corporation are taxed at the corporation level and the tax is accumulated in the “refundable capital gains tax on hand” account. The corporation uses this account to claim a capital gains refund when it distributes capital gains dividends to its shareholders. Since these dividends are capital gains distributions, they are taxed as capital gains in the hands of the shareholder and not as dividends.

Loss carry-overs

The cyclical nature of business and investment income suggests that the impact of such income should be viewed over a longer period of time rather than on an annual basis. As a result, carry-overs of losses are treated as part of the benchmark tax system. The loss carry-over rules permit taxpayers to apply their losses against past or future income. The estimates provided indicate approximately how much tax revenue the government foregoes by allowing current year losses to be carried back (i.e. applied to reduce tax paid in previous years) and by allowing losses of previous years to be applied to reduce tax otherwise payable for the current year. There are four types of losses that can be carried over, and specific provisions apply to each.

Non-capital losses

A non-capital loss is a company's loss from business operations. Non-capital losses may be carried back three years and forward seven years to reduce or offset the corporation's taxable income.

Estimates include the revenue impact of allowing non-capital losses of previous years to be applied to reduce Part I tax and the refundable Part IV tax otherwise payable for the current year. In addition, the estimates reflecting the impact of allowing current year losses to be carried back (i.e. applied to reduce income tax paid in previous years) include the impact of allowing current year losses to be carried back to reduce refundable Part IV tax.

Net capital losses

A net capital loss can arise from the disposition of capital property. This type of loss may be carried back three years and forward indefinitely but applied only against net capital gains that are taxable.

Estimates include the revenue impact of allowing net capital losses of previous years to be applied to reduce income tax otherwise payable for the current year and the impact of allowing current year net capital losses to be carried back (i.e. applied to reduce income tax paid in previous years).

Farm losses and restricted farm losses

A taxpayer who operates a farming or fishing business can deduct, in the calculation of net income, a loss incurred from a business operation. The unused losses of a given year may be carried back three years and forward 10 years.

When the major source of income is not farming, the amount of losses deductible in the year is restricted to a maximum of $8,750 against other income. The unused losses, defined as the excess of the net farm losses over the farm losses deductible in the year, are considered restricted farm losses. Restricted farm losses may also be carried back three years and forward 10 years but only against farm income.

Estimates include the revenue impact of allowing farming losses of previous years to be applied to reduce income tax otherwise payable for the current year.

Estimates for restricted farm losses are not significant.

Deductible meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

Until 1994, the deduction was limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment was part of a package price which included amounts not subject to the 80-per-cent limitation – for instance the fee for a conference – the taxpayer was required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation. Since 1994, the deductible portion of meals and entertainment expenses has been reduced to 50 per cent.

Large corporations tax

The large corporations tax (LCT) was introduced on July 1, 1989 as a tax on the Canadian capital of large corporations. The rate of tax in 1992, 1993 and 1994 was 0.2 per cent. The 1995 budget increased the LCT rate to 0.225 per cent effective budget day 1995.

This tax ensures that all large corporations, and groups of related corporations, with more than $10 million of taxable capital employed in Canada, pay some federal tax. Companies can reduce their LCT liability to the extent of the Canadian portion of their corporate surtax. The rate of corporate surtax was increased from 3 per cent to 4 per cent in the 1995 budget.

Threshold

The $10 million capital deduction effectively exempts smaller corporations from the LCT as long as these corporations are not related to other corporations subject to the LCT – that is, the $10 million deduction must be shared among related corporations. This capital deduction is not considered to be a tax expenditure because it is generally available to all corporations.

Exempt corporations

Certain corporations such as non-resident investment corporations, deposit insurance corporations and corporations exempt from paying Part I income tax are exempt from paying the LCT. This exemption is a tax expenditure, but data are not available to estimate its value.

Patronage dividend deduction

In computing income for a taxation year, a taxpayer is allowed to deduct patronage dividend payments made to customers. Patronage dividends are payments made to customers in proportion to their volume of business. The taxpayer is required to withhold 15 per cent of all patronage dividends in excess of $100 paid to each customer who is resident in Canada.

The appropriate benchmark tax treatment of patronage dividends is uncertain. These dividends could be considered to be analogous to the payment of a volume discount or the return of excess payments. With this view of the benchmark system, this would not be a tax expenditure.

Alternatively, these payments could be perceived as the distribution to members of earnings which would not be deductible under the benchmark system. The amount shown, reflecting this view of the benchmark system, is the revenue impact of allowing patronage dividends to be deductible from income.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of two-thirds of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province. This reduction in federal taxes can be argued to be a tax expenditure for the same reasons explained under the analysis of the resource allowance deduction.

Deductibility of provincial royalties (joint venture payments) for the Syncrude project (remission order)

Taxpaying participants in the Syncrude project are permitted to deduct both the resource allowance and "joint venture payments" made to the province of Alberta in lieu of a royalty in computing income subject to tax. This is accomplished through a remission order. Under the benchmark tax system, these joint venture payments, which are profit sensitive, would not be deductible. The estimate of the tax expenditure is calculated as the value provided by this extra deduction less the reduction in the resource allowance.

Deductibility of royalties paid to Indian bands

Royalties and lease rentals paid to Indian bands in respect of oil and gas and mining activities on Indian reservations are considered to be Crown charges paid to Her Majesty in Right of Canada or of a province in trust to the Indian band. Unlike non-deductible Crown charges, amounts paid to the benefit of an Indian band are generally deductible for federal income tax purposes. In addition to the deductible Crown charges, a resource allowance is earned on the resource profits net of the deductible Crown charges.

The amounts paid to the Government of Canada in the form of mining and oil and gas royalties/lease rentals paid to Indian bands are provided below:

Oil and gas and mining royalties/lease rentals paid to Indian bands

	1991-92	1992-93	1993-94	1994-95	1995-96
			($ millions)		
Oil and gas	53.0	50.0	59.0	76.0	58.0
Mining	1.0	0.8	0.6	0.7	0.5

Source: Indian and Northern Affairs Canada.

Non-resident-owned investment corporation refund

A non-resident-owned investment corporation must pay income tax at a rate of 25 per cent. However, except for capital gains realized on taxable Canadian property, this tax is refundable when the surplus is distributed as taxable dividends to the shareholders and the applicable rate of withholding tax then applies. The refund is designed to relieve the dividends paid to non-residents from double taxation that would otherwise result. The corporation is essentially treated as a conduit for the flow-through of income. The amounts reported estimate the tax revenues that would be generated if the non-resident-owned investment corporation refund was not available.

Investment corporation deduction

Investment income is taxed at the corporation level and in the hands of the individual who receives it as dividend payments. In order to achieve a certain degree of integration between the personal and corporate tax systems, the current rules allow an investment corporation to deduct from its Part I tax otherwise payable 20 per cent of the amount by which its taxable income exceeds its taxed capital gains.

Deferral of capital gains income through various roll-over provisions

The taxation of capital gains is affected by provisions that permit taxpayers to defer realization for tax purposes through various roll-over provisions. Since the benchmark tax structure includes all accrued gains, this item is identified separately for information purposes. Examples include:

- the transfer of assets to a corporation or partnership in consideration for share capital or a partnership interest;
- amalgamations of taxable Canadian corporations;
- the winding-up of a subsidiary corporation into its parent corporation; and
- share-for-share exchanges.

The 1994 budget made changes that curtail the use of various roll-over provisions in certain reorganizations.

No data are available.

Deduction for intangible assets

Three-quarters of eligible capital expenditures on intangible assets are added to the cumulative eligible capital of a taxpayer. A deduction of up to 7 per cent of cumulative eligible capital at the end of the year is allowed. Examples of intangible assets include goodwill, customer lists and franchises.

The deduction for intangible assets could give rise to positive or negative tax expenditure estimates depending on the actual rate of depreciation of these assets relative to the amount that is permitted for tax purposes.

No data are available.

Tax exemption on income of foreign affiliates of Canadian corporations

The Canadian system for taxing the income of foreign affiliates of Canadian shareholders or the dividend income of the Canadian shareholders derived from foreign affiliates is based on the objectives of encouraging international competitiveness, protecting the tax base and eliminating double taxation.

Where the foreign affiliate earns active business income, Canada defers any recognition of that income until it is paid to the Canadian shareholders as a dividend on shares of the affiliate. In cases where the business income has been earned in a country with which Canada has a double taxation treaty, the dividend paid out of that income to Canadian corporate shareholders is not subject to additional Canadian tax. Where the business income is earned in non-treaty countries, the dividend is taxed in Canada but a tax deduction is provided to Canadian corporate shareholders based on the underlying foreign tax paid.

Where the foreign affiliate earns passive income and the affiliate is a controlled foreign affiliate of a person resident in Canada, the passive income is taxed in the Canadian shareholder's hands on an accrual basis. The Canadian shareholder can deduct taxes paid in the foreign jurisdiction in determining net additional Canadian tax liability. When the income earned in the foreign affiliate is actually paid to the shareholder in the form of a dividend, a deduction from income subject to tax is provided to the extent that the income was included in income subject to tax in a previous year.

Questions arise as to what should be the appropriate benchmark system to measure the value of the tax expenditure, if any, in this case. Basically, three different benchmarks could be contemplated:

- Canada should tax only Canadian-source income. This is the territorial approach. Under this approach, foreign subsidiaries of Canadian companies would face the same tax burden on foreign-sourced business income as locally owned enterprises in the foreign jurisdiction. This approach is consistent with the concept of capital-import neutrality. Capital-import neutrality results when the shareholders of subsidiaries do not face additional taxes in Canada with respect to the foreign business

income earned by their subsidiaries. This is the effect of Canada's decision not to tax dividends arising from affiliates in countries with which Canada has entered into a double taxation agreement as a way to relieve double taxation. If this exempt dividend approach was to be considered as the benchmark, then no preference would be associated with the foreign dividend exemption.

- Income earned by a foreign affiliate should be taxable in Canada when dividends are paid to the Canadian shareholder and double taxation alleviated with a foreign tax credit. This is the approach used by a number of countries since it allows for additional taxes to be collected in the country of residence of the shareholder of a foreign affiliate at the time a dividend is paid to the shareholder by the affiliate out of foreign business income. These additional taxes would be levied when domestic tax payable exceeds the amount of foreign taxes paid both on the dividend itself and on the underlying foreign corporate profits out of which the dividend was paid. In Canada, dividends from foreign affiliates that do not qualify as exempt dividends are taxed on this basis. If this was to be considered the benchmark system, then the exempt dividend system would provide a preference, measured as the additional tax, net of the foreign tax credit, that would have been payable had the dividend been taxable in Canada.

- Income earned by foreign affiliates should be taxable in Canada as it accrues to the Canadian shareholder (i.e. on a current basis). This system is consistent with the concept of capital-export neutrality, which states that income of foreign affiliates should be subject to the same tax in the hands of its shareholders on a current basis regardless of whether the income is earned domestically or in a foreign affiliate. Certain passive income earned by controlled foreign affiliates is taxable on this basis in Canada. If this system was to be viewed as the benchmark, both the exempt dividend and the foreign tax credit approaches would be said to provide a preference measured as the deferral of incremental Canadian tax from the time the income is earned until the time the dividend is paid out.

Each of these three possible benchmarks has a policy justification. Data required to compute the amount of tax preference associated with any of the benchmarks are currently unavailable.

Chapter 5

Description of the Goods and Services Tax Provisions

Since the goods and services tax (GST) is levied at all points in the production and distribution chain, the value-added nature of the tax makes it equivalent to a retail sales tax levied on the sale of goods and services to the final consumer. Based on this equivalency, the GST base can be estimated from a Sales Tax Model constructed using data obtained from Statistics Canada's input-output tables and the National Income and Expenditure Accounts.

The data from the input-output tables are used to derive detailed expenditures by commodity for households, public sector bodies and exempt businesses. The personal expenditure categories of the input-output tables along with the investment categories for residential construction and real estate commissions are used to derive commodity expenditures for households. The commodity expenditures of public sector bodies are derived from certain personal expenditure categories, current government expenditure categories and appropriate investment categories contained in the input-output tables. (Public sector bodies include the federal government, provincial governments, municipalities, universities, school boards, public colleges, hospitals, charities and non-profit organizations.) The commodity expenditures of exempt businesses are derived from the input matrix of the input-output tables.

The commodity data described above are used to identify the impact of the GST provisions which either zero-rate or exempt certain goods and services. In some cases, modifications had to be made to the data derived from the input-output tables and the National Income and Expenditure Accounts to account for the structure of the GST. Since final input-output tables for a given year are available only four years after the fact, National Income and Expenditure Accounts data are used to project the impact of each GST provision to the relevant historical year. Expenditure data contained in the Department of Finance's Canadian Economic and Fiscal Model (CEFM) are used to project the impact of most of the GST provisions over the forecast period.

The Sales Tax Model is not the sole source of the estimated tax expenditures associated with the GST. In some cases, actual data from Revenue Canada were used for the tax expenditure estimates. In other cases, estimates were derived from entirely different sources. This chapter describes the various GST tax expenditure estimates and how they were derived.

Zero-Rated Goods and Services

Basic groceries

Basic groceries, which include the majority of foodstuffs for preparation and consumption at home, are zero-rated under the GST. However, the tax is charged on certain goods such as soft drinks, candies and confections, and alcoholic beverages.

The cost of the tax expenditure can be estimated using the Sales Tax Model by identifying commodities purchased by final consumers and public sector bodies which are currently not subject to tax. The majority of these purchases are contained in Statistics Canada's personal expenditure category "Food and Non-Alcoholic Beverages".

Prescription drugs

Drugs that are controlled substances for which a prescription is required are zero-rated. This provision also includes other drugs that have been prescribed by a recognized health care practitioner. The associated dispensing fee is also zero-rated. However, this provision excludes those items labelled or supplied for veterinary use.

The estimate is derived using the Sales Tax Model. However, an adjustment is made to reflect the fact that the input-output commodity "Pharmaceuticals" includes both prescription and non-prescription medicine. The ratio used to separate these two categories of medicine is based on information provided by Statistics Canada.

Medical devices

A wide range of medical devices is zero-rated under the GST. Included in this provision are canes; crutches; wheelchairs; medical and surgical prostheses; ileostomy and colostomy devices; artificial breathing apparatus; hearing and speaking aids; prescription eyeglasses and contact lenses; various diabetic supplies; and selected devices for the blind and for the hearing or speech impaired. In some instances, a device qualifies for tax-free status only if it is prescribed by a recognized health care practitioner.

The estimate is obtained using the Sales Tax Model. The zero-rated medical devices are found in the input-output commodities "Personal Medical Goods", "Medical and Dental Equipment and Supplies", and "Ophthalmic Goods". An adjustment is made to reflect the fact that the input-output commodities "Personal Medical Goods" and "Ophthalmic Goods" include expenditures made by final consumers which are not zero-rated under the medical devices provision. The ratio used to separate the zero-rated from the non-zero-rated expenditures is based on information provided by Statistics Canada.

Agricultural and fish products and purchases

Instead of taxing sales and providing input tax credits at early stages in the food production-distribution chain, certain agricultural and fish products are zero-rated throughout. A prescribed list of such supplies includes farm livestock, poultry, bees, grains and seeds for planting or feed, hops, barley, flax seed, straw, sugar cane or beets, etc. In addition, prescribed sales and purchases of major types of agricultural and fishing equipment are zero-rated.

The main effect of this provision is on the cash-flow position of taxpayers. For example, in the normal operation of the GST, farmers would pay the GST on taxable purchases and would claim a corresponding input tax credit at the end of their tax period. However, in the case of prescribed zero-rated supplies, the farmer does not pay the GST and so does not have to wait to claim an input tax credit. Consequently, the cash-flow position of the farmer is improved. At the same time, however, the suppliers lose the benefit of holding the GST on these purchases until the end of their tax period. Since the aggregate tax liability of these taxpayers remains unchanged, the revenue implications of this measure are small.

Certain zero-rated purchases made by exporters

Certain supplies of goods and services delivered in Canada but subsequently exported are zero-rated. These include:

- the supply of goods to a recipient who intends to export them, provided they are not excisable goods (spirits, beer or tobacco) and the goods are not further processed or modified in Canada by the recipient;
- the supply of excisable goods to a recipient who, in turn, exports the goods in bond;
- supplies of natural gas made to a person who is exporting the gas by pipeline and not further processing or using the gas in Canada before its exportation other than as fuel or compressor gas to transport the gas; and
- goods sold to duty-free shops licensed as such under the *Customs Act*.

As with agricultural and fish products, this provision has only cash-flow implications. Again, the impact of this measure on tax revenues is small.

Non-taxable importations

Certain importations are tax free under the GST. These importations include:

- goods, other than books and periodicals, valued at not more than $20 and mailed to residents of Canada from other countries;

- duty-free personal importations such as goods valued at not more than $500 and imported by Canadians who have been outside the country for more than seven days (the limit was $300 prior to June 13, 1995); and
- goods imported by foreign diplomats.

No data are available.

Tax-Exempt Goods and Services

Long-term residential rent

Rentals of a residential complex (such as a house) or a residential unit (such as an apartment) for a period of at least a month are tax exempt. Short-term accommodation is also exempt where the charge for the accommodation is not more than $20 per day.

The estimate is derived using the Sales Tax Model based on the GST being applied to the input-output commodity “cash rent”, and incorporates the loss of the GST currently paid on business inputs purchased by the landlord. In addition, the estimate captures the GST being applied to certain consumer expenditures on the commodity “other rent” which represents exempt purchases of parking privileges associated with rental accommodation.

Health care services

Health care services are exempt under the GST. These services include the following categories:

- institutional health care services provided in a health care facility. These include accommodation, meals provided with accommodation, and rentals of medical equipment to patients or residents of the facility. However, it excludes meals served in a cafeteria, parking charges or haircuts for which a separate fee is charged;
- services provided by certain health care practitioners who must be licensed or otherwise certified to practise the particular profession in provinces. This category includes services such as dental, optometric, chiropractic, physiotherapy, chiropodic, podiatric, osteopathic, audiological and psychological services. It also includes speech therapy and occupational therapy; and
- services covered by a provincial health insurance plan. Most of these services are already covered by the previous two provisions.

All those exempt services which are covered by provincial health insurance plans are included in the benchmark because, constitutionally, the GST cannot apply to purchases made by provincial governments. Thus, the only cost from this provision involves health services purchased by final consumers. The estimates for this provision are derived from the Sales Tax Model.

Education services (tuition)

The GST provides an exemption for most educational services. The exemption includes tuition fees paid for courses provided primarily for elementary or secondary school students; courses leading to credits towards a diploma or degree awarded by a recognized school authority, university or college; and certain other types of training for a trade or vocation. In addition, the exemption covers meals supplied to elementary or secondary students as well as most meal plans at a university or public college.

The estimate is derived from the revenues that would be collected if tuition fees were taxed and input tax credits were allowed for taxable purchases. The estimate takes into account the fact that universities and public colleges currently receive a rebate of 67 per cent of the tax that they pay on their purchases.

The estimate is derived from the Sales Tax Model based on the input-output commodity “Education Services” augmented by data contained in Statistics Canada’s publication *Education Quarterly Review*.

Child care and personal services

Certain child and personal care services are exempt under the GST. The exemption covers the following:

- child care services provided for periods of less than 24 hours to children under 14 years of age; and
- certain personal care services including supplies of care and supervision to residents of an institution, as well as accommodation where it is provided for children or disabled or underprivileged persons.

The estimate is derived using the Sales Tax Model based on the input-output commodity “Personal Services, including Child Care” contained in the final demand category “Domestic and Child Care Services”. The estimate reported here does not account for day care which might be paid by governments, or day care provided by a non-profit organization. However, the impact of these exclusions on the overall estimate is unclear since provincial expenditures would not be subject to tax and the remaining expenditures would be eligible for partial rebates if taxed.

Legal aid services

Legal services provided under a provincially authorized legal aid program are exempt under the GST. This includes payments by the client in respect of the legal aid services and payments by a legal aid society to a private lawyer for legal services.

There are two ways in which the tax is relieved:

- legal aid services delivered directly by the Crown or a Crown agency (as is the case in Nova Scotia, Newfoundland, Prince Edward Island, Quebec, Manitoba and Saskatchewan) are exempt; and

- legal aid provided by private practitioners to a legal aid plan administrator is taxable. However, the person responsible for the legal aid plan is entitled to a rebate of 100 per cent of any tax paid on the supply.

Revenue Canada supplied the data related to the rebates provided to legal aid plans in the provinces of New Brunswick, Ontario, Alberta and British Columbia. To account for the other provinces where the service is explicitly exempt, provincial economic accounts data are used. Specifically, it is assumed that the value of legal aid services relative to the total expenditures contained in the provincial economic account category "Personal Business" in the tax-exempt provinces would be the same as in those provinces where a rebate is provided.

The projected expenditure estimate is based on the growth in consumption obtained from the CEFM.

Ferry, road and bridge tolls

International ferry services are treated as zero-rated like other international transportation services. Other ferry, road and bridge tolls are exempt under the GST.

The estimate is derived using the Sales Tax Model based on the expenditures of final consumers on the commodity "Highway and Bridge Maintenance".

Municipal transit

Municipal transit service is defined as a public passenger transportation service provided by a transit authority whose services are at least 90 per cent within a particular municipality and its surrounding areas. These municipal transit services are exempt under the GST.

The estimate is derived using the Sales Tax Model.

Exemption for small businesses

Businesses or individuals with annual sales of $30,000 or less from taxable and zero-rated transactions may elect to be exempt under the GST. Such firms would not have to charge tax on their sales and would not be able to claim input tax credits on their business purchases.

The starting point in deriving the estimate is gross sales data for 1990 obtained from personal and corporate income tax information. From this data, one can estimate that the total sales from firms with annual sales of less than $30,000 accounts for approximately 0.5 per cent of all sales in the Canadian economy. This ratio can then be applied to the total gross GST collections to approximate the revenues which would arise from eliminating the small business threshold.

The projected expenditure estimate is based on the growth in nominal gross domestic product (GDP) obtained from the CEFM.

Quick method accounting

Small businesses registered under the GST are eligible to elect to account for GST using Quick Method Accounting. Under the scheme, businesses do not have to keep track of the tax paid on most of their inputs. Instead, these firms remit a prescribed percentage of the GST which they collect on their sales. The remaining GST collected is kept by the firm in lieu of the unaccounted input tax credits. The firm is eligible to claim an input tax credit for the tax paid on capital goods.

The estimate is derived from micro-statistical data for 1991 supplied by Statistics Canada. The take-up rate of this provision for eligible small businesses is about 22 per cent. The estimate for subsequent historical years is derived by projecting the 1991 estimate based on information regarding the growth in total input tax credits claimed which is obtained from Revenue Canada.

The projected expenditure estimate is based on the growth in nominal GDP obtained from the CEFM.

Water and basic garbage collection services

Water and basic garbage collection services are exempt under the GST. Charges levied for water and basic garbage collection services are captured in the commodity "Water, Waste Disposal and Other Utilities" contained in the input-output tables. The estimate is derived from the Sales Tax Model.

Domestic financial services

Financial services are defined to include services relating to financial intermediation, market intermediation and risk pooling. However, in many cases, the price of a financial service is implicit. For example, when banks provide lending and deposit-taking services, the bank's fee for these services is the spread between interest rates received from borrowers and the interest paid to depositors. The exact price associated with each financial transaction is difficult to determine and, therefore, it is difficult to apply the GST to the sale of the service. As a result, most financial services provided to residents of Canada are exempt under the GST.

The GST also permits corporations to elect to be treated as "closely related" if there is at least 90-per-cent common ownership. The purpose of this provision is to allow for grouping only in those situations where the members of the group operate, for all intents and purposes, like a single company. As a result, members of a closely related group which contains a listed financial institution may make an election that deems supplies of services and property made between them to be exempt financial services.

Data are not available.

Certain supplies made by non-profit organizations

The supply of goods and services supplied by non-profit organizations which are exempt under the GST include recreational services provided primarily to children aged 14 and under; recreational services provided to the underprivileged or disabled; supplies of food, beverage and lodging to relieve poverty or distress of individuals; and certain amateur performances.

No data are available.

Tax Rebates

Rebates for municipalities

Recognized municipalities are entitled to a rebate of 57.14 per cent of the GST paid on their purchases used in the course of supplying exempt municipal services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1995.

Rebates for hospitals

Public hospitals are eligible for a rebate of 83 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1995.

Rebates for schools

Elementary and secondary schools, operating on a not-for-profit basis, are eligible for a rebate of 68 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1995.

Rebates for universities

Universities which are recognized degree-granting institutions operating on a not-for-profit basis are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1995.

Rebates for colleges

Public colleges which are funded by a government or municipality and whose primary purpose is to provide vocational, technical or general education are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1995.

Rebates for charities

Charities registered under the *Income Tax Act* are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the expenditures of charities are captured in Statistics Canada's definition of personal expenditures, the projected estimate is based on the growth in consumer expenditures obtained from CEFM.

Rebates for non-profit organizations

The organizations eligible for this rebate are government-funded non-profit organizations. They include registered amateur athletic associations and organizations operating a facility or part thereof to provide nursing home intermediate care or residential care, which receive at least 40 per cent of their funding from governments, municipalities or Indian bands. These organizations are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the expenditures of non-profit organizations are captured in Statistics Canada's definition of personal expenditures, the projected estimate is based on the growth in consumer expenditures obtained from CEFM.

Rebate for book purchases made by qualifying institutions

On October 23, 1996, the Minister of Finance announced that a 100-per-cent GST rebate would be provided on all book purchases made by public libraries, schools, universities, public colleges, municipalities, public hospitals and qualifying charities and non-profit organizations.

The initial expenditure estimate for 1997 is the estimated annual cost of implementing this provision. The projected expenditure estimate is based on appropriate expenditure data obtained from the CEFM.

Housing rebate

Purchasers of newly constructed residential dwellings and substantially renovated houses are eligible for a rebate of the GST paid if the purchaser is acquiring the dwelling as a primary place of residence. For houses priced at or below $350,000, the rebate is 36 per cent of the total GST paid to a maximum of $8,750. The rebate is phased out for houses priced between $350,000 and $450,000.

The estimate for historical years is obtained from Statistics Canada's National Income and Expenditure Accounts. The projected expenditure estimate is based on the growth in investment in new residential construction obtained from the CEFM.

Rebate to foreign visitors on accommodation

Non-residents visiting Canada are entitled to a rebate for the GST paid on most goods and short-term accommodation. Specifically, the rebate covers:

- goods for use primarily outside Canada, excluding excisable goods such as alcoholic beverages and tobacco products, provided the goods are exported within 60 days of purchase;
- the tax paid on short-term lodging, but not including meals, where the period of stay is less than one month; and
- the total tax paid must be at least $14.

However, goods for use outside Canada are essentially the same as other exported goods and should be considered as part of the benchmark. Thus, the cost of this provision is only the rebate associated with short-term accommodation.

Revenue Canada has some data related to the cost of the tourist rebate. However, these data are not sufficient to estimate the tax expenditure associated with the tourist rebate. Specifically, it is not possible to identify the value of the rebates that are conferred to businesses which include these rebates as part of their input tax credits.

Special credit for certified institutions

A special credit was provided in the period from January 1, 1991 to the end of 1995 to certified institutions which employ mentally or physically disabled individuals in the manufacturing of goods. This credit was calculated on the basis of 100 per cent of the GST collected from sales on manufactured goods in 1991, 75 per cent in 1992, 50 per cent in 1993 and 25 per cent in both 1994 and 1995.

No data are available.

The GST credit

As part of the introduction of the GST, a GST credit was established to ensure that families with annual incomes below $30,000 would be better off under the new sales tax regime. The amount of the GST credit depends upon family size and income. Currently, the basic adult credit is $199. Families with children 18 years and younger receive a basic child credit of $105 for each child. However, single parents can claim a full adult credit of $199 for one dependent child. In addition to their basic credit, single adults (including single parents) are eligible for an additional credit of up to $105. The value of the credit is reduced for families with incomes of over $25,921. Both the credit amounts and the income threshold are adjusted annually to increases in the consumer price index in excess of 3 per cent.

The estimate for historical years is based on data from Revenue Canada. The projected expenditure estimate is obtained from the Department of Finance's fiscal forecast.

Memorandum Items

Meals and entertainment expenses

In the normal operation of the GST, registrants are allowed to claim full input tax credits for the tax paid on their purchases. However, in the case of the tax paid on meals, beverages and entertainment expenses, the registrant is allowed to recover only 50 per cent of the GST paid as an input tax credit. (Prior to February 1994, the input tax credit for business meals and expenses was 80 per cent.) There is no input tax credit allowed for the GST paid on membership fees or dues in any club the main purpose of which is to provide dining, recreational or sporting facilities.

The estimate is based on the cost of the meals and entertainment tax expenditures contained in the Personal and Corporate Income Tax Expenditure tables. These figures are first grossed up to arrive at the total meals and entertainment expenses in the entire economy using the marginal federal income tax rates by sector. Then, 15 per cent is removed to account for expenses incurred in GST-exempt activities since they are ineligible for any input tax credits. The cost of this provision is equal to the above net expenses multiplied by 7 per cent.

Rebate to employees and partners

A rebate is available to certain employees of a GST registrant for the GST paid on those expenses that are deductible in computing the employee's income from employment for income tax purposes. For example, the employee is allowed to claim a rebate equal to 7/107ths of the capital cost allowance on an automobile, aircraft or musical instrument that is used in his or her employment and on which GST is payable. Also, the GST rebate is available to an individual who is a member of a GST-registered partnership in respect of expenses incurred outside the partnership that are deducted in computing the member's income from the partnership for the purposes of the *Income Tax Act*.

The estimate for historical years is based on data from Revenue Canada. The projected expenditure estimate is based on the growth in nominal GDP obtained from the CEFM.

Sales of personal-use real property

The sale of personal-use real property by an individual or a trust (all the beneficiaries of which are individuals) is exempt under the GST. Examples include the sale of used owner-occupied homes and country properties kept for personal use. However, the exemption does not include real property that is sold in the course of business.

No data are available.

GOVERNMENT OF CANADA

TAX EXPENDITURES

1998

Canada

Government of Canada
Tax Expenditures

1998

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Table of Contents

Chapter 1
Interpreting Tax Expenditures: A Guide

What is a Tax Expenditure?

Governments have a variety of economic and social objectives. One instrument to achieve these objectives is public spending. It has often been argued that governments have the flexibility to use tax concessions, as a substitute for direct public spending, to achieve the same objectives. Such tax concessions are generally referred to as tax expenditures.

Tax Expenditures Versus Tax Concessions

While all tax expenditures are tax concessions, it does not follow that all tax concessions are tax expenditures.

To estimate tax expenditures, one needs to determine whether a tax concession is a substitute for spending. There are a number of considerations in this regard that need to be taken into account.

- Although a tax concession is generally considered to be a deviation from a benchmark tax structure, no consensus exists as to what constitutes a benchmark tax structure. Hence, there is no general agreement on whether or not a specific item is a tax concession. For example, is the lowest, 17-per-cent personal income tax rate in Canada a tax concession or is it part of the underlying tax structure? For the purpose of this report, this rate is considered a part of the underlying structure of the tax system.
- Difficulties also arise when trying to determine whether a tax concession is a substitute for direct spending. For example, the dividend tax credit simply offsets the tax paid at the corporate level to avoid double taxation, and hence should not be classified as a tax expenditure.

Naturally, given these difficulties, there is a large element of subjectivity in defining tax expenditures. As a result, international comparisons of tax expenditures are not very useful.

The Canadian Approach

The Canadian approach seeks to provide as much information as possible to the reader, without getting into a controversy as to whether or not an item is a tax expenditure. Consequently, any deviation from a narrowly defined tax structure is reported. This allows the reader to decide whether or not a particular tax concession qualifies as a tax expenditure. This information on deviations from the tax system is reported in two parts: one includes a list of all items that could be considered to be tax expenditures under a very broad (and perhaps unrealistic) definition. All other deviations from the tax system are reported as memorandum items.

International Comparisons

Relative to other countries, Canada has taken a broad approach to reporting tax expenditures.

In the United Kingdom, tax concessions are reported under three categories. The first category, structural relief, incorporates both tax concessions that are a fundamental part of the tax structure and those which simplify administration and compliance. In contrast, the second category, tax expenditures, consists of tax concessions which are considered alternatives to direct spending. The third category comprises those tax reliefs which contain elements of both structural reliefs and tax expenditures and, thus, cannot be classified explicitly as either structural reliefs or tax expenditures. Thus, all tax concessions are reported, but direction is given to the reader as to the appropriate classification of each.

In the United States, the method of reporting tax expenditures is slightly different. The United States reports tax expenditures against two different tax structures: normal and reference law. The normal tax structure reflects a comprehensive income tax system. Under the normal tax structure, any deviation from the basic tax structure is reported as a tax expenditure. The reference law baseline, however, more closely reflects existing tax law. Under reference law, tax expenditures are limited to those deviations from the tax structure that serve program functions.

Caveats

Care must be taken in interpreting the estimates and projections of tax expenditures in the tables for the following reasons.

- Tax expenditures are values of tax revenues forgone to achieve a variety of economic and social objectives. Whether or not the magnitudes of tax expenditures are appropriate depends upon an evaluation of the social and economic policies that generated them. The values reported in the tables provide no information towards such an evaluation.
- Estimates of various tax expenditure items cannot be added together – this is because the cost of each tax expenditure is estimated separately, assuming that all other tax provisions remain unchanged.
- The estimates assume all other factors remain unchanged (i.e. there is no allowance for behavioural changes, consequential government policy changes or changes in aggregate economic activity in response to the change in the tax expenditure).
- In addition to these considerations, the projections are subject to forecast error and are "best efforts" which have no greater degree of reliability than the variables that explain them.

What's New in the 1998 Report?

- For the first time, the specific objectives of each tax concession are included in Chapter 7. The objectives were obtained from budget documents, speeches and other government sources, and represent the original intention of each tax concession and the general goals each was expected to fulfil.
- Estimates and projections for the changes to both the tax expenditures and memorandum items proposed in the 1998 budget have been added. These include:

Personal Income Tax Measures

General income tax relief

Increasing tax-free income for low-income Canadians
(supplementary low-income credit) – memorandum item

Canadian Opportunities Strategy

Tax relief for interest on student loans
(student loan interest credit)

Support for families

New tax credit for caregivers

Strengthening communities and the voluntary sector

Emergency volunteers
(replaces non-taxation of allowances to volunteer firefighters)

Business Income Tax Measures

Countervailing and anti-dumping duties
Earthquake reserves

Sales Tax Measures

Respite care
Measures affecting charities (charities operating bottle returns) – memorandum item

- The 1998 budget also proposed several changes which would affect existing tax expenditures. For example, the limits for the child care expense deduction were increased by $2,000 to $7,000 for children under 7 or disabled and by $1,000 to $4,000 for older children. In addition, premiums paid by the self-employed for private health service plans were made deductible. These proposed changes have been incorporated into the projections for these measures.
- As usual, other minor changes have been made to provide information that was not previously available and to update or otherwise improve the descriptions of certain measures.

What is in the Report?

- Chapter 2 presents estimates of tax expenditures and memorandum items.
- Chapter 3 provides the methodology used to derive these estimates.
- Chapters 4 (personal income tax), 5 (corporate income tax) and 6 (GST) provide simplified descriptions of each tax expenditure as well as information on the data sources and methodology used in constructing the estimates.
- Chapter 7 sets out the stated objectives for all tax expenditures contained in this report. This responds to a request from the Auditor General in his April 1998 report.

Chapter 2

Estimates and Projections

Tables 1 to 3 provide tax expenditure values for personal income tax, corporate income tax and the goods and services tax (GST) for the years 1993 to 2000. In the case of personal income tax, tax expenditures are grouped according to functional categories. This grouping into functional categories is not intended as a policy justification for the specific provisions nor is it the case that all tax measures fall neatly into one of the categories. The categories are provided solely for organizational purposes.

All estimates are reported in millions of dollars. The letter "S" indicates that the cost is less than $2.5 million while "n.a." signifies that data were not available. The inclusion in the report of items for which estimates are not available is warranted given that the report is designed to provide information on the type of assistance delivered through the tax system even if it is not always possible to provide a quantitative estimate. Work is continuing to obtain quantitative estimates where possible. For example, the corporate income tax entries dealing with advertising costs were "n.a." in last year's report. In this year's publication, dollar values are reported for these tax expenditures.

Table 1
*Personal income tax expenditures**

	Estimates			Projections				
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
Culture and recreation								
Deduction for clergy residence	48	49	50	51	52	52	53	54
Flow-through of CCA on Canadian films[1]	16	12	48	–	–	–	–	–
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S	S	S	S	S	S	S
Write-off of Canadian art purchased by unincorporated business	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assistance for artists	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction for artists and musicians	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of capital gains on gifts of cultural property	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education								
Tuition fee credit[2]	175	185	195	220	275	290	310	335
Education credit[3]	43	43	44	58	105	200	205	205
Education and tuition fee credits transferred[4]	190	205	215	255	270	285	300	315
Carry-forward of tuition and education credits[5]	–	–	–	–	–	10	25	40
Student loan interest credit[6]	–	–	–	–	–	120	135	150

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 45-47 for a discussion of the reasons for this.

Personal income tax expenditures (cont'd.)

	Estimates			Projections				
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
Exemption on first $500 of scholarship,fellowship and bursary income	7	6	6	6	6	6	6	6
Deduction of teachers' exchange fund contributions	S	S	S	S	S	S	S	S
Registered education savings plans[7]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Employment								
Deduction of home relocation loans	3	2	3	2	2	2	2	2
Non-taxation of allowances to volunteer firefighters[8]	4	4	4	4	4	–	–	–
Deduction for emergency service volunteers[8]	–	–	–	–	–	14	14	14
Northern residents deductions[9]	190	155	125	125	130	130	130	130
Overseas employment credit	33	30	31	38	34	34	34	34
Employee stock options[10]	57	56	74	120	125	130	135	140
Non-taxation of strike pay[11]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of salary through leave of absence/ sabbatical plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Employee benefit plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Family								
Spousal credit	1,205	1,190	1,200	1,190	1,200	1,205	1,215	1,220
Equivalent-to-spouse credit	455	470	470	460	465	465	470	475
Infirm dependant credit[12]	12	10	6	7	58	58	58	58

Personal income tax expenditures (cont'd.)

	Estimates			Projections				
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Caregiver credit[6]	–	–	–	–	–	120	125	125
Child tax benefit[13]	5,275	5,240	5,230	5,185	5,240	5,525	6,000	6,395
Deferral of capital gain through transfer to spouse	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Farming and fishing								
$500,000 lifetime capital gains exemption for farm property[14]	405	470	275	320	295	295	295	295
Net Income Stabilization Account (NISA)[15]								
Deferral of tax on government contributions[16]	n.a.	43	31	110	92	78	78	78
Deferral of tax on bonus and interest income	n.a.	8	14	18	21	37	48	57
Taxable withdrawals	n.a.	-15	-15	-33	-36	-28	-28	-28
Deferral of income from destruction of livestock	S	S	S	S	S	S	S	S
Deferral of income from grain sold through cash purchase tickets[17, 18]	-10	31	19	6	19	19	19	19
Deferral through 10-year capital gain reserve[17]	-5	14	8	5	5	5	5	5
Deferral of capital gain through intergenerational roll-overs of family farms	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Exemption from making quarterly tax instalments	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Cash basis accounting	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Flexibility in inventory accounting	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Federal-provincial financing arrangements								
Quebec abatement	2,140	2,185	2,320	2,410	2,580	2,715	2,840	2,955
Transfers of income tax room to provinces	8,870	9,090	9,745	10,240	10,975	11,560	12,155	12,725

Personal income tax expenditures (cont'd.)

	Estimates			Projections				
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
General business and investment								
$100,000 lifetime capital gains exemption[19, 20]	1,170	8,815	35	–	–	–	–	–
Partial inclusion of capital gains	385	385	405	315	325	335	345	355
Deduction of limited partnership losses[17, 21]	215	295	195	180	210	210	210	210
Investment tax credit[17, 22]	125	70	54	42	55	55	55	55
Deferral through five-year capital gain reserve[17]	-33	-27	-6	-22	-22	-22	-22	-22
Deferral through capital gains roll-overs	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction of accelerated tax depreciation[23]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
$1,000 capital gain on personal-use property	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
$200 capital gain on foreign exchange transactions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Taxation of capital gains upon realization	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health								
Non-taxation of business-paid health and dental benefits[24]	1,200	1,270	1,440	1,485	1,515	1,590	1,650	1,695
Disability credit	270	275	270	265	270	270	275	280
Medical expense credit[25]	260	260	305	330	390	420	450	475
Medical expense supplement for earners[5]	–	–	–	–	40	40	40	40
Income maintenance and retirement								
Non-taxation of guaranteed income supplement and spouse's allowance benefits	225	260	285	285	290	295	305	310
Non-taxation of social assistance benefits[26]	680	705	635	620	595	595	595	595

Personal income tax expenditures (cont'd.)

		Estimates				Projections		
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
Non-taxation of workers' compensation benefits[17, 27]	610	585	635	625	625	625	625	625
Non-taxation of amounts received as damages in respect of personal injury or death	18	20	20	19	19	19	19	19
Non-taxation of employer-paid premiums for group term life insurance of up to $25,000[28]	165	87	–	–	–	–	–	–
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from Allied countries)[29]	6	6	4	3	S	S	S	S
Non-taxation of veterans' disability pension and support for dependants	140	140	140	140	140	140	140	140
Treatment of alimony and maintenance payments[30]	220	260	250	260	250	250	250	250
Age credit[31]	1,370	1,290	1,270	1,295	1,335	1,410	1,445	1,475
Pension income credit	305	325	350	360	370	380	385	390
Saskatchewan Pension Plan	S	S	S	S	S	S	S	S
Registered retirement savings plans								
Deduction for contributions	4,490	4,785	5,290	5,820	6,400	7,040	7,745	8,520
Non-taxation of investment income[32]	3,325	3,565	3,850	3,885	3,740	4,415	5,445	6,160
Taxation of withdrawals	-930	-1,620	-1,750	-1,895	-2,055	-2,230	-2,420	-2,625

Personal income tax expenditures (cont'd.)

	Estimates			Projections				
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
				($ millions)				
Registered pension plans								
Deduction for contributions	5,205	4,890	4,925	5,070	5,225	5,380	5,540	5,710
Non-taxation of investment income[32]	8,610	9,540	10,040	9,455	8,490	9,315	10,655	11,165
Taxation of withdrawals	-4,930	-4,010	-4,520	-4,970	-5,455	-6,465	-6,015	-7,275
Non-taxation of RCMP pensions/compensation in respect of injury, disability or death[33]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferred profit-sharing plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of up to $10,000 of death benefit	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of investment income on life insurance policies[34]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Small business								
$500,000 lifetime capital gains exemption for small business shares[17, 35]	1,170	1,725	590	475	620	620	620	620
Deduction of allowable business investment losses[17, 36]	100	77	79	62	70	70	70	70
Labour-sponsored venture capital corporations credit[37, 38]	58	110	235	90	85	85	85	85
Deferral through 10-year capital gain reserve[17]	5	4	-2	2	2	2	2	2
Other items								
Non-taxation of capital gains on principal residences[39]								
Partial inclusion rate	1,790	1,795	1,085	1,245	1,415	1,425	1,450	1,495
Full inclusion rate	2,385	2,390	1,445	1,660	1,885	1,905	1,930	1,995

Personal income tax expenditures (cont'd.)

	Estimates			Projections				
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
Non-taxation of income from the Office of the Governor General	S	S	S	S	S	S	S	S
Assistance for prospectors and grubstakers	S	S	S	S	S	S	S	S
Charitable donations credit[40]	880	900	940	980	1,040	1,070	1,105	1,135
Reduced inclusion rate for capital gains arising from certain charitable donations[5]	–	–	–	–	90	95	100	105
Gifts to the Crown credit[41]	14	21	34	30	30	30	30	30
Political contribution credit[17]	20	9	10	10	10	10	10	10
Non-taxation of income of Indians on reserves	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of gifts and bequests	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memorandum items								
Non-taxation of lottery and gambling winnings[42]	910	960	1,155	1,185	1,235	1,290	1,340	1,390
Non-taxation of specified incidental expenses	6	6	6	6	6	6	6	6
Non-taxation of allowances for diplomats and other government employees posted abroad	8	8	9	9	9	9	9	9
Child care expense deduction[43]	305	305	395	415	435	520	525	535
Attendant care expense deduction	S	S	S	S	S	S	S	S
Moving expense deduction[17]	66	64	61	61	63	63	63	63
Deduction of carrying charges incurred to earn income[17, 44]	540	540	645	575	590	590	590	590
Deduction of meals and entertainment expenses[45]	110	110	97	120	105	105	105	105
Deduction of farm losses for part-time farmers	50	48	52	54	52	52	52	52

Personal income tax expenditures (cont'd.)

	Estimates			Projections				
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Farm and fishing loss carry-overs[17]	11	9	10	8	9	9	9	9
Capital loss carry-overs[17]	89	87	89	87	87	87	87	87
Non-capital loss carry-overs[17]	73	74	86	75	75	75	75	75
Logging tax credit	S	S	S	S	S	S	S	S
Deduction of resource-related expenditures[46]	78	77	78	170	110	110	110	110
Deduction of other employment expenses	490	540	540	575	600	620	650	670
Deduction of union and professional dues	465	465	505	505	515	525	535	545
Employment insurance								
Employment insurance contribution credit	1,230	1,300	1,320	1,255	1,280	1,275	1,325	1,310
Non-taxation of employer-paid premiums	2,510	2,655	2,710	2,580	2,630	2,625	2,725	2,695
Canada and Quebec Pension Plans								
Canada and Quebec Pension Plan credit	985	1,055	1,135	1,190	1,300	1,525	1,755	2,050
Non-taxation of employer-paid premiums	1,270	1,360	1,465	1,530	1,510	1,655	1,940	2,230
Foreign tax credit[47]	185	220	280	295	340	375	410	450
Dividend gross-up and credit	635	645	730	815	865	930	995	1,055
Supplementary low-income credit[6, 48]	–	–	–	–	–	140	300	315
Basic personal credit	17,130	17,325	17,650	17,820	18,245	18,830	19,395	19,735
Non-taxation of capital dividends	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes

1 The increase in this tax expenditure in 1995 reflects increases in the average amount of capital cost allowance (CCA) claimed and the number of individuals claiming CCA in that year. The flow-through of CCA on Canadian films is not available for taxation years later than 1995, and is replaced by a tax credit to producers.

2 The 1997 budget proposed to extend this credit to most mandatory ancillary fees imposed by post-secondary institutions, beginning in 1997.

3 The 1996 budget increased this credit from $80 to $100 per month, beginning in 1996. The 1997 budget proposed to increase this credit to $150 per month for 1997, and $200 per month thereafter. The 1998 budget proposed to allow part-time students to claim a part-time education amount of $60 per month.

4 The 1996 budget increased from $4,000 to $5,000 the limit on the transfer of these amounts, beginning in 1996.

5 This measure was proposed in the 1997 budget.

6 This measure was proposed in the 1998 budget.

7 Very little information is available. In light of the increasing importance of registered education savings plans (RESPs), the 1997 budget indicated that Revenue Canada will require additional information from RESP trustees, including the amount of the funds accumulated in these plans. The 1996, 1997 and 1998 budgets reported estimates of the revenue cost of changes to RESPs that were based on conservative assumptions about the impact of the measures on take-up.

8 The 1998 budget proposed to replace the $500 tax-free allowance for volunteer firefighters with a deduction of up to $1,000 for emergency service volunteers. The tax expenditure estimate for the emergency service volunteer deduction includes claims by firefighters after 1997.

9 The lower level of the tax expenditure after 1993 reflects the fact that residents of communities no longer eligible for benefits following the reform of northern benefits were eligible for two-thirds benefits in 1993, one-third benefits in 1994, and none thereafter.

10 The increase in this tax expenditure in 1996 reflects a 30-per-cent increase in the number of claimants, and a 25-per-cent increase in the average claim in that year, based on preliminary information.

11 Statistics Canada no longer collects data on strike pay in Canada.

12 Effective in 1993 with the introduction of the child tax benefit, the dependant credit can no longer be claimed for children under age 17. The decline in this tax expenditure for 1995 reflects a 35-per-cent decrease in the number of claimants in that year. The 1996 budget increased the maximum credit per dependant from $270 to $400.

13 The 1996 budget increased this tax benefit. The 1997 and 1998 budgets proposed additional enrichments to this provision (see Chapter 4). Payments made between January and December of the year are reported.

14 The decline in this tax expenditure in 1995 reflects a 20-per-cent decrease in the number of claimants, and a 25-per-cent decrease in the average claim in that year.

15 The data used to determine the Net Income Stabilization Account tax expenditures for 1993, published in the 1995 report, were incomplete. Since all of the data required are still not available, the tax expenditure for 1993 cannot be estimated.

16 The high level of this tax expenditure in 1996 reflects special start-up payments to farmers in Saskatchewan in that year.

17 This tax expenditure is highly volatile. It is projected at its historical average.

[18] The amounts reported in previous years for this tax expenditure were based upon total sales, including sales by farming corporations. As the deferral of tax on these sales represents a corporate income tax expenditure, the previously published estimates for this expenditure have been revised. The personal income tax expenditure associated with this measure is now estimated as $ -12 million for 1991 and $ -8 million for 1992. Please see Table 2 of this report for estimates of the value of the associated corporate income tax expenditure for this item.

[19] The large increase in this tax expenditure in 1994 reflects the special election to claim the exemption for eligible capital gains accrued up to February 22, 1994 on 1994 tax returns.

[20] The lifetime capital gains exemption for general property is not available for taxation years later than 1994. The tax expenditure for 1995 reflects late and adjusted elections filed in that year with respect to gains accrued up to February 22, 1994.

[21] The high value of this tax expenditure in 1994 reflects a 40-per-cent increase in the average loss claim in that year. The decline in the value of this tax expenditure in 1995 reflects a 40-per-cent decline in the number of claimants in that year.

[22] The high value of this tax expenditure in 1993 reflects a temporary small business investment tax credit. The tax credit was provided for investments in eligible machinery and equipment made after December 2, 1992 and before 1994.

[23] This tax expenditure includes the deduction of scientific research and experimental development expenditures. Accurate data are not available to estimate this tax expenditure with precision.

[24] The 1998 budget proposed to allow unincorporated owner-operators to deduct premiums for supplementary health care coverage against their business income to a maximum amount, beginning in 1998.

[25] The 1997 budget proposed a broadening of this credit to cover additional expenses, beginning in 1997.

[26] The decline in this tax expenditure in 1996 reflects preliminary information, suggesting lower levels in future years.

[27] The increase in this tax expenditure in 1995 reflects a 10-per-cent increase in the number of claimants in that year.

[28] These amounts became taxable after July 1, 1994.

[29] The expected decrease in this tax expenditure is in line with the historical trend.

[30] The 1996 budget eliminated the income inclusion for recipients of child support payments, and disallowed the deduction to payers, for agreements made after April 30, 1997.

[31] These amounts became income-tested in 1994.

[32] Projected values for this tax expenditure are lower than those provided in last year's publication due to lower than expected interest rates in those years.

[33] The amounts reported in previous years for this tax expenditure included taxable amounts and did not cover all non-taxable RCMP pensions. This tax expenditure cannot be estimated with precision.

[34] Although this measure does provide tax relief for individuals, it is implemented through the corporate tax system. See the corporate income tax expenditure section of this report for an estimate of the value of this tax expenditure.

[35] The high value of this tax expenditure in 1994 reflects a 30-per-cent increase in the average claim in that year. The decline in this tax expenditure in 1995 reflects a 50-per-cent decline in the number of claimants, and a 15-per-cent decline in the average claim in that year. The decline in this tax expenditure in 1996 reflects a further 25-per-cent decline in the average claim, partially offset by a 10-per-cent increase in the number of claims in that year, based on preliminary information.

[36] The decline in the value of this tax expenditure in 1996 reflects a 10-per-cent decline in the number of claimants, and a 15-per-cent decline in the average claim in that year, based on preliminary figures.

The 1996 budget reduced this credit from 20 per cent to 15 per cent, and the purchase amount eligible for credit from $5,000 to $3,500 per year, for purchases made after March 5, 1996.

[38] The high value of this tax expenditure in 1995 reflects record sales of shares of labour-sponsored venture capital corporations for that year. The decline in the value of this expenditure in 1996 reflects a 30-per-cent decline in the number of claimants, and a 45-per-cent decline in the average claim in that year, based on preliminary figures.

[39] The decline in this tax expenditure in 1995 reflects declines in home values and home sales in that year. Overall, this tax expenditure is expected to remain below its 1994 value, reflecting projected home values and sales.

[40] The 1994 budget lowered the threshold at which charitable donations begin to earn the 29-per-cent credit from $250 to $200. The 1996 and 1997 budgets proposed additional enrichments to this credit (see Chapter 4).

[41] The increase in the value of this tax expenditure in 1995 reflects a 10-per-cent increase in the number of claimants, and a 45-per-cent increase in the average claim in that year.

[42] This estimate assumes that the total amount of lottery and horse racing winnings would be included in income and subject to tax. However, there is some uncertainty regarding the proper benchmark tax system in this area. For example, if the benchmark system included taxation of winnings, it would also have to include a deduction for the purchase cost of tickets. A threshold below which winnings would not be taxable may also be necessary, due to the large administrative cost of taxing very small prizes. In addition, proceeds from the sale of lottery tickets are an important source of funds for provincial governments and not-for-profit organizations. As a result, there is already an element of taxation to lottery and gambling proceeds. This estimate is therefore included as a memorandum item only.

[43] The 1996 budget broadened eligibility criteria for claiming this deduction, beginning in 1996. The 1998 budget proposed to increase the maximum claim under this provision, and to extend it to part-time students, beginning in 1998.

[44] The increase in this tax expenditure in 1995 reflects a 10-per-cent increase in the average claim in that year. The decline in this tax expenditure in 1996 reflects a 15-per-cent decrease in the number of claimants in that year, based on preliminary information.9

[45] The deduction is limited to 50 per cent of eligible amounts incurred after February 1994. Amounts incurred earlier were deductible at 80 per cent.

[46] The increase in this tax expenditure in 1996 reflects a 40-per-cent increase in the number of claimants, and a 55-per-cent increase in the average claim in that year, based on preliminary information.

[47] The expected increase in this tax expenditure is in line with the historical trend.

[48] The 1998 budget also proposed relief from the general surtax for low- and middle-income taxpayers. This proposal represents a change in the benchmark tax system, and consequently there is no associated tax expenditure.

Table 2
*Corporate income tax expenditures**

	Estimates		Projections[2]					
	1993[1]**	1994**	1995	1996	1997	1998	1999	2000
				($ millions)				
Tax rate reductions								
Low tax rate for small businesses	2,145	2,365	2,565	2,645	2,835	2,980	3,050	3,105
Low tax rate for manufacturing and processing[3]	530	1,005	1,520	1,320	1,415	1,485	1,525	1,550
Low tax rate for credit unions	45	38	42	44	47	49	51	51
Exemption from branch tax for transportation, communications, banking and iron ore mining corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemption from tax for international banking centres	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax credits								
Investment tax credits								
SR&ED investment tax credit[4]	770	885	930	980	1,035	1,090	1,150	1,210
Atlantic investment tax credit[5]	65	105	175	270	200	100	100	100
Special investment tax credit[6]	22	29	38	–	–	–	–	–
Cape Breton investment tax credit[7]	S	–	–	–	–	–	–	–
Small business investment tax credit[8]	94	84	–	–	–	–	–	–
ITCs claimed in current year but earned in prior years[9]	260	555	365	395	420	455	485	520
Political contribution tax credit	S	S	S	S	S	S	S	S
Canadian film or video production tax credit[10]	–	–	9	34	36	37	39	40

* The elimination of tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 45-47 for a discussion of the reasons for this.

** An industry breakdown of 1993 and 1994 corporate tax expenditures can be obtained on request.

Table 2
***Corporate income tax expenditures** (cont'd.)*

	Estimates		Projections					
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
Exemptions and deductions								
Partial inclusion of capital gains	535	525	550	575	605	635	670	700
Royalties and mining taxes								
Non-deductibility of Crown royalties and mining taxes	-350	-385	-395	-435	-450	-405	-430	-440
Resource allowance	480	540	555	610	635	575	600	620
Earned depletion[11]	85	21	50	40	30	25	10	10
Deductibility of charitable donations	78	89	110	130	140	145	150	155
Deductibility of gifts to the Crown	S	5	3	4	5	5	5	5
Interest on small business financing loans	S	S	S	S	S	S	S	S
Non-deductibility of advertising expenses in foreign media	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of provincial assistance for venture investments in small business	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferrals								
Accelerated write-off of capital assets and resource-related expenditures[12]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Table 2
***Corporate income tax expenditures** (cont'd.)*

	Estimates		Projections					
	1993	1994	1995	1996	1997	1998	1999	2000
				($ millions)				
Allowable business investment losses[13]	49	22	22	25	25	26	28	29
Holdback on progress payments to contractors[14]	19	15	18	15	18	17	17	17
Available for use	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Capital gains taxation on realization basis	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Expensing of advertising costs[15]	4	18	8	10	10	10	10	10
Deductibility of contributions to mine reclamation and environmental trusts[16]	–	15	15	15	15	15	15	15
Deductibility of countervailing and anti-dumping duties[17]	–	–	–	–	–	n.a.	n.a.	n.a.
Deductibility of earthquake reserves[18]	–	–	–	–	–	15	20	25
Cash basis accounting	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Flexibility in inventory accounting	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of income from grain sold through cash purchase tickets[19]	-3	13	7	S	7	7	7	7
Deferral of income from destruction of livestock[20]	S	S	S	S	S	S	S	S
Deferral of tax from use of billed-basis accounting by professionals	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
International								
Non-taxation of life insurance companies' world income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemptions from non-resident withholding tax[21]								
Copyright royalties[22]	81	23	57	60	63	66	69	72

Table 2
***Corporate income tax expenditures** (cont'd.)*

	Estimates		Projections					
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Royalties for the use of, or right to use, other property[23]	40	49	51	150	160	165	175	185
Interest on deposits	325	400	425	420	410	425	430	430
Interest on long-term corporate debt	460	515	545	535	530	550	550	550
Dividends[24]	74	21	52	62	68	70	72	74
Management fees	10	16	17	18	19	19	20	21
Exemption from Canadian income tax of income earned by non-residents from the operation of a ship or aircraft in international traffic	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other tax expenditures								
Transfer of income tax room to provinces in respect of shared programs	450	560	695	700	765	805	820	825
Interest credited to life insurance policies	63	70	73	74	77	81	85	90
Non-taxation of registered charities and other non-profit organizations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Income tax exemption for provincial and municipal corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of certain federal Crown corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Excise tax transportation rebate[25]	23	S	–	–	–	–	–	–
Aviation fuel excise tax rebate[26]	–	–	–	–	n.a.	n.a.	n.a.	n.a.

Table 2
***Corporate income tax expenditures** (cont'd.)*

	Estimates		Projections					
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Surtax on the profits of tobacco manufacturers[27]	–	-45	-60	-65	-65	-70	-70	-15
Temporary tax on the capital of large deposit-taking institutions[28]	–	–	-40	-60	-65	-70	-75	–
Memorandum items								
Refundable Part I tax on investment income of private corporations	805	855	1,045	955	995	1,030	1,080	1,120
Refundable capital gains for investment corporations and mutual fund corporations	220	170	225	220	230	240	255	265
Loss carry-overs[29]								
Non-capital losses carried back[30]	1,035	850	745	995	960	1,055	1,190	1,320
Non-capital losses applied to current year[31]	1,990	2,135	3,050	2,245	2,785	2,705	2,680	2,695
Net capital losses carried back	75	84	62	83	80	88	99	110
Net capital losses applied to current year[32]	62	130	150	225	170	165	160	160
Farm losses applied to current year[33]	4	8	11	12	12	13	13	14
Deductible meals and entertainment expenses[34]	260	240	195	200	205	215	225	230
Large corporations tax								
Threshold[35]	430	485	520	555	565	575	590	600
Exempt corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Patronage dividend deduction	100	145	210	225	245	255	260	265

Table 2
Corporate income tax expenditures *(cont'd.)*

	Estimates		Projections					
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Logging tax credit[36]	35	88	75	30	20	35	35	35
Deductibility of provincial royalties (joint venture payments) for the Syncrude project (remission order)[37]	5	11	35	63	32	24	16	15
Deductibility of royalties paid to Indian bands	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-resident-owned investment corporation refund	92	60	105	115	130	145	160	180
Investment corporation deduction	S	S	S	S	S	S	S	S
Deferral of capital gains income through various roll-over provisions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction for intangible assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax exemption on income of foreign affiliates of Canadian corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes

1 The 1993 figures are based upon final data and may differ from the figures in last year's edition of this document which were based on preliminary data.

2 Unless otherwise indicated in the footnotes, changes in the projections from the figures in last year's edition of this document result from changes in the explanatory economic variables upon which the projections are based.

3 The increases over the 1993 to 1995 period in the revenue cost of the low tax rate for manufacturing and processing (M&P) profits reflect both a decrease in the tax rate on M&P profits from 23 per cent to 21 per cent and an increase in the level of M&P profits. The decrease from 1995 to 1996 reflects a projected decrease in the level of M&P profits.

4 The increase between 1993 and 1994 is largely attributable to an increase in the number of taxpayers claiming scientific research and experimental development (SR&ED) tax credits and to investment tax credit (ITC) rule changes. Prior to 1994, there was annual limitation on the amount of ITCs that could be utilized. SR&ED tax credits earned but not claimed or refunded in a current year may be carried forward. When claimed, these unused credits are included under ITCs claimed in a current year but earned in prior years.

5 The projected cost of the tax expenditure declines in 1997 because a large portion of this tax expenditure relates to the Hibernia offshore oil project which will complete its investment phase before the end of 1998.

6 New investments did not earn this credit after December 31, 1994. Credits not claimed in 1994 and prior years may be carried forward. However, they are included in the forecasts for ITCs claimed in a current year but earned in prior years.

7 The Cape Breton investment tax credit was applicable to eligible equipment acquired after May 23, 1985 and before 1993. When claimed, Cape Breton ITCs earned before 1993 and claimed after 1993 are included under ITCs claimed in a current year but earned in prior years.

8 Since the small business investment tax credit was available for eligible expenditures on machinery and equipment acquired after December 2, 1992 and before 1994 only, the revenue cost is concentrated in the 1993 and 1994 taxation years. Unclaimed credits are carried forward and may be claimed in subsequent years. When claimed, these unused credits are included under ITCs claimed in a current year but earned in prior years.

9 All ITCs earned in previous years but not claimed until the current year are included under this item. Because this tax expenditure fluctuates significantly from year to year, the tax expenditure projections are based upon an average of the amounts of 1992 to 1994.

10 This measure was introduced in 1995.

11 Due to the elimination of the earned depletion allowance, there have been no additions to this tax expenditure pool since 1989. Amounts claimed in the current years relate to depletion earned in 1989 and prior years.

12 This tax expenditure consists of the fast write-off of certain capital assets, including capital equipment used for SR&ED, and of resource exploration and development expenditures and energy conservation and efficiency equipment. See text on page 88 for a further explanation of why no figures have been calculated.

13 The tax expenditure for allowable business investment losses fluctuates from year to year depending upon the amount of current year losses and the availability of income against which to apply these losses. The decrease in the tax expenditure amount from 1993 to 1994 results from a decrease in the amount of losses realized.

14 The amount of this tax expenditure can fluctuate significantly from year to year depending primarily upon the level of construction activity.

15 Estimates and projections were not previously provided for this item. The 1991 and 1992 estimates are less than $2.5 million.

16 This measure was introduced in 1994.

17 This measure was introduced in 1998.

18 This measure was introduced in 1998.

19 Estimates and projections were not previously provided for this item. The 1991 and 1992 estimates are $-3 million and $-4 million respectively.

20 Estimates and projections were not previously provided for this item. The 1991 and 1992 estimates are less than $2.5 million.

[21] These estimates are based on the benchmark assumption that no behavioural response would occur after the hypothetical removal of existing withholding tax exemptions. This assumption is particularly difficult to sustain for this type of tax, as indicated in the text, which means that the amounts shown in the table should not be regarded as estimates of the revenue gain that would be realized from the hypothetical removal of the listed withholding tax exemptions.

[22] The decline from 1993 to 1994 is due to a decline in the level of exempt payments made to non-residents. Such a decline can be expected on occasion since the events that trigger such payments will not necessarily occur on a regular basis.

[23] The large increase from 1995 to 1996 can be attributed to protocol changes to the Canada-U.S. tax treaty.

[24] The decline from 1993 to 1994 is due to a decline in the level of exempt payments made to non-residents. Such a decline can be expected on occasion since the events that trigger such payments will not necessarily occur on a regular basis.

[25] This measure was effective for 1991 and 1992 calendar years only. The 1993 estimate has been decreased by $45 million from the previous publication to reflect the repayment of rebates.

[26] This measure is effective for the years 1997 to 2000 inclusive.

[27] This measure was introduced in 1994 and is scheduled to expire in 2000.

[28] This measure was introduced in the 1995 budget, and extended in the 1996, 1997 and 1998 budgets. The measure is scheduled to expire after October 31, 1999.

[29] The impact of loss carry-overs can fluctuate significantly from year to year depending upon the amount of current and prior years' losses and the availability of income against which to apply these losses.

[30] The decrease in this amount over the 1993 to 1995 period results from a decrease in the amount of losses available for carry-back to reduce income of prior years.

[31] The increase in this amount over the 1993 to 1995 period results from an increase in the amount of income against which to apply losses of prior years.

[32] The increase in this amount over the 1993 to 1996 period results from an increase in the amount of income against which to apply losses of prior years.

[33] The increase in this amount over the 1993 to 1995 period results from an increase in the amount of income against which to apply losses of prior years.

[34] The decrease in the tax expenditure for meals and entertainment expenses over the 1993 to 1995 period reflects the impact of the decrease in the deductible portion of such expenses from 80 per cent to 50 per cent, effective after February 1994.

[35] The large corporations tax rate increased to 0.225 per cent from 0.2 per cent, effective February 28, 1995. Therefore, the value of the exempt threshold was increased for taxpayers.

[36] The increase in the revenue cost for this item in 1993 to 1995 can be attributed to an increase in the profitability of the industries subject to logging taxes and the refunds of softwood lumber countervailing duties paid to the U.S. in 1992 and 1993 following a tribunal ruling in favour of Canadian exporters.

[37] The amount of this tax expenditure can fluctuate significantly from year to year depending primarily upon profitability and capital expenditures. These two factors can change the payments made under the joint venture agreement with the Government of Alberta. The large decrease from 1996 to 1997 can be attributed to changes in the joint venture agreement, implemented on January 1, 1997.

Table 3
*GST tax expenditures**

	Estimates				Projections			
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Zero-rated goods and services								
Basic groceries	2,550	2,595	2,675	2,760	2,885	3,080	3,190	3,320
Prescription drugs	265	275	285	300	315	335	350	370
Medical devices	140	145	150	155	165	175	185	195
Agricultural and fish products and purchases	S	S	S	S	S	S	S	S
Certain zero-rated purchases made by exporters	S	S	S	S	S	S	S	S
Non-taxable importations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Zero-rated financial services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax-exempt goods and services								
Long-term residential rent	1,395	1,450	1,500	1,555	1,575	1,585	1,595	1,650
Health care services	325	340	355	385	430	475	495	525
Education services (tuition)	330	340	350	370	395	430	445	470
Child care and personal services	170	175	180	185	200	215	225	240
Legal aid services	30	30	30	30	30	35	40	40
Ferry, road and bridge tolls	5	5	5	5	5	5	5	5
Municipal transit[1]	55	50	50	45	45	50	50	55
Exemption for small business	100	105	105	110	120	125	130	135
Quick method accounting	115	130	135	150	160	165	175	185
Water and basic garbage collection services	80	80	85	90	90	90	90	90

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 45-47 for a discussion of the reasons for this.

Table 3
GST tax expenditures

	Estimates				Projections			
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Domestic financial services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Certain supplies made by non-profit organizations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax rebates								
Rebates for book purchases made by qualifying public institutions[2]	n.a.	n.a.	n.a.	S	25	25	30	30
Housing rebate[3]	500	520	415	435	520	545	555	605
Rebate for foreign visitors on accommodations[4]	45	50	55	65	70	75	75	80
Rebates for municipalities[5]	510	530	565	540	540	540	540	540
Rebates for hospitals[5]	275	275	270	250	250	250	250	250
Rebates for schools[5]	305	290	300	285	285	285	285	285
Rebates for universities[5]	120	120	120	115	115	115	115	115
Rebates for colleges[5]	50	50	55	50	50	50	50	50
Rebates for charities	135	135	140	140	150	160	165	175
Rebates for non-profit organizations[6]	75	70	70	65	70	75	80	80
Tax Credits								
Special credit for certified institutions	n.a.	n.a.	n.a.	–	–	–	–	–
The GST credit	2,645	2,785	2,820	2,850	2,895	2,980	2,975	2,970

Table 3
GST tax expenditures

	Estimates				Projections			
	1993	1994	1995	1996	1997	1998	1999	2000
	($ millions)							
Memorandum Items								
Meals and entertainment expenses[7]	145	115	100	105	105	110	115	115
Rebate to employees and partners	65	70	60	70	75	75	80	85
Sales of personal-use real property	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes

1 The decline in this expenditure over the 1993 to 1996 period can be attributed to declines in municipal spending. The projected increase for the 1997 to 2000 period reflects the underlying economic forecast used to project the expenditure over the period.

2 This measure was introduced in October 1996.

3 The sharp decline in 1995 reflects the significant weakness in residential construction in that year.

4 Estimates of this tax expenditure were derived as part of the review of a Visitors' Rebate Program.

5 Since the value of this tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1996.

6 Estimates of the expenditure over the historical period have been revised to reflect revisions in the administrative data.

7 The numerical approach used to derive the tax expenditure figures is tightly integrated with the tax expenditure estimates reported for the personal and corporate tax system. The decline in 1994 largely reflects the reduction in the eligibility limit for meal and entertainment expenses from 80 per cent to 50 per cent.

Chapter 3

Framework and Methodology

Introduction

The purpose of this report is to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada's federal income tax system and the goods and services tax (GST). It is also an important input into the process of evaluating the operation of these tax systems. However, it should be emphasized that this report itself does not attempt to make judgements about either the appropriateness of government policy objectives or the effectiveness of the various tax provisions in achieving those objectives.

The principal function of taxes is to raise the revenues necessary to finance government operations. This tax revenue is often raised in a way which, at the same time, implements government policy objectives by providing assistance or incentives to particular groups of individuals, businesses or to certain types of activities. These measures, which can take the form of tax exemptions, deductions, rebates, deferrals or credits, are typically referred to as tax expenditures. This document provides historical estimates, based on a sample of taxpayer returns, of the cost of these items for the last years for which data are available. In the case of the personal income tax system, these are 1993, 1994 and 1995. For the corporate income tax system, they are 1993 and 1994. The GST estimates are for the years 1993 to 1996. In addition, it also provides projections of these tax expenditures, beyond the last historical year, to 2000.

In order to identify tax expenditures, it is necessary to establish a "benchmark" tax structure which does not contain any preferential tax provisions. Tax expenditures are then defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the definition of the benchmark tax system, and hence what constitutes a tax expenditure. For example, child care expenses could be considered to be a cost of earning income and therefore part of the benchmark tax system; if not, then tax assistance for child care expenses would be a tax expenditure.

This report takes a broad approach – only the most fundamental structural elements of each tax system are considered to be part of the benchmark. By defining the benchmark in this manner, many tax provisions are treated as tax expenditures. This approach provides information on a full range of measures, and so allows readers who take a different position as to the appropriate benchmark system to construct their own list of tax expenditures.

In keeping with this objective of providing as much information as possible, the document identifies several tax provisions that are not generally considered to be tax expenditures even though they reduce the amount of revenue collected. These measures are denoted as "memorandum items" and have been included simply to provide additional information. Three types of memorandum items are included.

- Measures that are considered to be part of the benchmark system. The dividend tax credit, for example, reduces or eliminates the double taxation of income earned by corporations and distributed to individuals through dividends.
- Measures where there may be some debate over whether the item should be considered to be a tax expenditure. The cost of business-related meals and entertainment, for example, may be considered to be an expense incurred in order to earn income (and therefore part of the benchmark) or may be considered to provide a benefit (and therefore constitute a tax expenditure).
- Measures where the available data do not permit separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. For example, a portion of tax-free allowances for Members of Parliament (MPs) is used to cover legitimate employment expenses (and is therefore part of the benchmark for the income tax system) while the rest may be used for personal consumption (and is therefore an income tax expenditure). Since it is not possible to distinguish between these two elements, the non-taxation of such allowances is included as a memorandum item.

The federal and provincial income tax and sales tax systems interact with each other to various degrees. As a result, changes to tax expenditures in the federal system may have consequences for provincial tax revenues. In this publication, however, any such provincial effects are not taken into account – that is, the tax expenditure estimates are purely federal in nature.

The remainder of this chapter discusses the tax expenditure concept in order to facilitate understanding of the quantitative estimates. It also discusses the calculation and interpretation of the costs of tax expenditures, including key assumptions used in the analysis. Chapter 2 presented estimates of the costs of tax expenditures and memorandum items in the personal and corporate income tax systems and the GST.

Simplified descriptions of each tax expenditure as well as information on data sources and methodology used in constructing the estimates are presented in Chapter 4 (personal income tax), Chapter 5 (corporate income tax) and Chapter 6 (GST). Chapter 7 sets out the stated objectives for each of the tax expenditures in each tax system.

What are tax expenditures?

Tax expenditures are those tax incentives that are used as alternatives to direct government spending for achieving government policy objectives.

While there is agreement on this conceptual definition of a tax expenditure, difficulties arise in making this definition operational. There is no widely accepted operational methodology for estimating tax expenditures. A range of methodologies exists internationally, some restrictive, others very broad. The broadest of the available options is to estimate tax expenditures as all deviations from a benchmark tax system. Typically, these deviations take the form of exemptions, deductions, rate reductions, rebates, credits or deferrals. It is to be expected that such a wide interpretation will produce a list which includes many items that are not tax expenditures. It is this interpretation of tax expenditures that is used here to provide as much information as possible on deviations from the benchmark tax system.

Elements of Tax Expenditures in the Personal and Corporate Income Tax Systems

The benchmark for the personal and corporate tax systems includes the existing tax rates and brackets, unit of taxation, time frame of taxation, treatment of inflation for calculating income and those measures designed to reduce or eliminate double taxation.

The definition of income is crucial in determining what constitutes a tax expenditure. Tax provisions that provide for the deduction of current costs incurred to earn income are considered to be part of the benchmark system and therefore not tax expenditures. For example, the deductibility of labour costs or economic depreciation of business assets in determining business income would not be considered a tax expenditure.

It is important to emphasize that the definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. Reasonable differences of opinion may exist as to the interpretation and categorization of tax measures. For example, employment insurance (EI) premiums paid by an employee could be viewed either as an expense of earning income or as a tax used to finance an income transfer to the unemployed. From the first perspective, the current system of providing employees a tax credit for contributions would not be a tax expenditure. The credit for EI premiums merely recognizes an expense of earning income and, hence, is part of the benchmark tax structure. On the other hand, one could argue that the tax credit for EI contributions represents a tax expenditure because the taxes paid by taxfilers are generally not deductible against personal income taxes. For this reason the tax treatment of EI premiums is reported as a memorandum item. Measures such as these which are subject to debate are discussed on an individual basis in Chapters 4 and 5.

The following provides a more detailed discussion of the features of the benchmark for both the personal and corporate tax systems.

(1) Tax rates and income brackets

For the personal income tax system, the existing rate structure, including surtaxes, is taken to be part of the benchmark system. The basic personal credit is also treated as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax up to an initial level of income. However, the cost of this credit is included as a memorandum item.

With respect to the corporate income tax system, effective after February 27, 1995, the basic federal corporate tax rate is 29.12 per cent including the surtax but after the provincial abatement. Provisions that reduce this tax rate for certain types of activities or corporations are regarded as tax expenditures. These include the lower tax rate for manufacturing and processing profits, and the lower tax rate for small business profits, which is available on the first $200,000 of active business income earned by most Canadian-controlled private corporations (CCPCs). The large corporations tax, levied at the existing rate, is also considered to be part of the benchmark tax system.

(2) Tax unit

Personal income taxes in Canada are based on individual income. Consequently, the individual is taken as the benchmark tax unit for the purposes of identifying tax expenditures in this report. This choice leads to the classification of the various provisions related to dependants, such as the spousal credit, as tax expenditures.

The choice of the appropriate unit for the corporate income tax benchmark system raises a number of conceptual issues. There is a wide range of possible tax units, including the establishment or activity unit within a corporation, the single legal corporate entity, and the consolidated group of related corporations. The present income tax system contains elements of all these approaches. For example, the view that the activity unit is the appropriate unit of taxation is consistent with the “at-risk” rules, which restrict the amount of investment tax credits and business losses that may be flowed out to limited partners. The view that the single legal corporate entity is the relevant tax unit is supported by the fact that income from one part of a business can be offset by other business losses within the same corporation, whereas losses by one corporation may not generally be used against the income of another corporation in the group. Other provisions in the current tax system allow corporate groups to reorganize their corporate structures without triggering any capital gains or recaptured depreciation. These roll-over provisions lead to a deferral of capital gains and recaptured depreciation, which would be appropriate if the taxation unit is the consolidated group of related corporations. On balance, the view most closely related to the existing system is that of the single legal corporate entity. For this reason, the single corporation is adopted as the benchmark tax unit, together with the availability of various roll-over provisions which permit the deferral of capital gains when a corporate structure is changed.

(3) Taxation period

The benchmark taxation period for the personal income tax system in this document is the calendar year. Accordingly, any measures that provide deferrals of taxable income to a subsequent year are considered to be tax expenditures. For example, farmers are permitted to defer the receipt of income from the sale of grain through the use of special cash purchase tickets and this is listed as a tax expenditure.

The benchmark taxation period for the corporate income tax system is the fiscal year. As with the personal tax system, deferrals, such as the accelerated write-off of capital assets, are considered to be tax expenditures.

A strict application of the annual taxation period would imply that measures which provide for the carry-over of losses to other years would be tax expenditures. However, the relatively cyclical nature of business and investment income suggests that such income should be viewed over a number of years. Consequently, carry-overs of business and investment losses are treated as part of the benchmark tax system in this report. Estimates of the cost of these provisions are provided in the memorandum items section.

(4) Treatment of inflation

Both the personal and corporate income tax systems are based on nominal income with a number of provisions that account for the impact of inflation. Nominal income is therefore taken as the appropriate basis for the benchmark tax system. Consequently, special measures, such as the partial exclusion of capital gains from taxable income, which may serve to recognize inflation, are identified as tax expenditures.

(5) Avoidance of double taxation

Conceptual difficulties arise in deciding whether certain provisions which reduce or eliminate double taxation should be considered as tax expenditures.

For example, regarding the personal and corporate income tax systems as completely separate would suggest that the dividend tax credit is a tax expenditure. However, the credit is an essential feature of the overall (i.e. both corporate and personal) income tax structure and serves to eliminate or reduce double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation and once at the personal level. For this reason, the dividend tax credit is not considered to be a tax expenditure.

Similarly, the non-taxation of intercorporate dividends is designed to ensure that income already taxed in one corporation is not taxed again upon receipt of a dividend by another corporation. Without this exemption, double taxation would occur and the corporate income tax system would not be neutral across organizational structures. For example, consider a single corporation that currently operates as a number of divisions. Now suppose it reorganizes into a holding company with wholly owned subsidiaries instead of divisions. The profits from the subsidiaries flow to the holding company through intercorporate dividends. If these dividends were subject to taxation at both

the subsidiary and the holding company levels, double taxation would occur. Consequently, the exemption of intercorporate dividends is not considered a tax expenditure.

Similar reasoning applies to the tax exemption on income of foreign affiliates of Canadian corporations. Canada either exempts certain dividend income paid by foreign affiliates from Canadian corporate income tax or it provides a foreign tax credit for income taxes paid in the other country. In either case, the intention is to ensure that income is not subject to double taxation (i.e. once in the country of residence of the foreign affiliate and once again in Canada when the dividends are paid out). A further discussion of this topic and the possible benchmarks that could be considered is contained in Chapter 5.

Information on some of these measures that provide relief from "double taxation" is provided in the appropriate memorandum sections of this report.

The benchmark for the income tax system

The definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. A broadly based system is used as the benchmark for income taxes in this report. The essential features are:

Personal income tax

- *the existing tax rates and income brackets are taken as given;*
- *the tax unit is the individual;*
- *taxation is imposed on a calendar year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the dividend gross-up and credit.*

Corporate income tax

- *the existing general tax rate is taken as given;*
- *the tax unit is the corporation;*
- *taxation is imposed on a fiscal year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the non-taxation of intercorporate dividends.*

Tax Expenditures in the Goods and Services Tax[1]

The benchmark system used to analyze the GST is a broadly based, multi-stage value-added tax collected according to the destination principle and using a tax credit mechanism to relieve the tax in the case of business inputs. The following provides a more detailed discussion of the features of the GST benchmark.

(1) Multi-stage system

The main structural elements of a multi-stage consumption tax are taken to be part of the benchmark. Under the multi-stage system, tax is applied to the sales of goods and services at all stages of the production and marketing chain. At each stage, however, businesses are able to claim tax credits to recover the tax they paid on their business inputs. In this way, the tax system has the effect of applying the tax only to the value added by each business. Since the only tax that is not refunded is the tax collected on sales to final consumers, the tax rests ultimately on final consumption.

(2) Destination-based

The benchmark system applies tax only to goods and services consumed in Canada. Accordingly, the tax applies to imports as well as domestically produced goods and services. Exports are not subject to the tax.

(3) Single tax rate

The benchmark system has only one tax rate. This rate corresponds to the statutory rate of 7 per cent. As a result, GST provisions that depart from this single rate are considered to be tax expenditures.

(4) Taxation period

The benchmark taxation period is the calendar year.

(5) Constitutional provisions for government sectors

Section 125 of the *Constitution Act, 1867,* provides that "no land or property belonging to Canada or any province shall be liable to taxation". This means that neither the federal nor the provincial governments (or their Crown agents) are liable to taxation by the other. Accordingly, constitutional immunity from taxation is recognized as part of the benchmark system for the GST.

[1] It should be noted that this analysis deals only with the GST and not with other commodity taxes (e.g., excise taxes). The exclusion of these other commodity taxes recognizes the inherent conceptual difficulties of defining an appropriate benchmark system in the context of a tax which is applied to a specific commodity. Work is continuing on defining an appropriate benchmark system which would allow the future measurement of the associated tax expenditures.

The benchmark also recognizes that the federal and provincial governments have taken steps to simplify the operation of the tax for transactions involving government sectors.

- The federal government decided to apply the GST to purchases by federal departments and Crown corporations in order to keep the tax as simple as possible for vendors. As a result, the GST and the benchmark system treat federal Crown corporations in the same manner as any other business entity.
- By virtue of Section 125, provincial governments and Crown agents are not liable to pay the GST on their purchases. However, the federal government and most provinces have entered into Reciprocal Tax Agreements (RTAs). These agreements specify situations in which each level of government agrees to pay the sales taxes of the other, and generally this involves applying tax to purchases made by Crown corporations. As a result, provincial Crown corporations are treated like any other business entity in the benchmark system.

Unlike provincial governments, municipalities are liable to pay the GST. Therefore, the benchmark system considers them as paying tax on their purchases. Universities, colleges, schools and hospitals are also considered to pay tax on their purchases. The GST and the benchmark generally treat these sectors as final consumers – that is, they pay GST on their purchases, they do not claim input tax credits and they do not collect GST on their sales.

The only exception to this benchmark treatment arises from the fact that municipalities, universities, colleges, schools and hospitals engage in certain commercial activities analogous to those provided in the private sector. For example, some municipalities operate golf courses. Such commercial activities are taxable under the GST and the GST paid on associated inputs can be claimed as input tax credits.

The benchmark for the goods and services tax

The essential features are:

- *basic structural features of a broadly based, multi-stage tax system;*
- *destination approach;*
- *7-per-cent rate;*
- *calendar year basis for the taxation period; and*
- *recognition of constitutional provisions for government sectors.*

Types of GST tax expenditures

Comparing the actual structure of the GST to the benchmark system, it is possible to identify four types of tax expenditure:

- zero-rated goods and services;
- tax-exempt goods and services;
- tax rebates; and
- tax credits.

(i) Zero-rated goods and services

Under the GST, certain categories of goods and services are considered to be taxed at a "zero" rate, rather than at the general tax rate of 7 per cent. Vendors do not charge GST on their sales of zero-rated goods and services (whether these sales are to other businesses or to final consumers). However, vendors are entitled to claim input tax credits to recover the GST they paid on inputs used to produce zero-rated products. As a result, zero-rated goods and services are tax free.

One category of zero-rated sales is basic groceries – i.e. foods intended to be prepared and consumed at home. Other categories of zero-rated sales include prescription drugs, medical devices and most agricultural and fish products.

(ii) Tax-exempt goods and services

Some types of goods and services are exempt under the GST. This means that the GST is not applied to these sales. Unlike zero-rated goods and services, however, vendors of exempt products are not entitled to claim input tax credits to recover the GST they paid on their inputs to these products.

Examples of tax-exempt goods and services include long-term residential rents, most health and dental care services, day-care services, most sales by charities, most domestic financial services, municipal transit and legal aid services.

(iii) Tax rebates

Certain sectors are eligible for rebates on a portion of the GST paid on inputs. For example, there are rebates for schools, universities, hospitals and municipalities. To the extent that these sectors make taxable sales, they can claim input tax credits to recover the tax they paid on inputs to these sales. Where they provide tax-exempt services, however, they are eligible to receive rebates for only a portion of the GST paid on their inputs to these services. These rebates ensure that these institutions do not bear a greater tax burden on their purchases under the GST than they would have under the manufacturers' sales tax, which the GST replaced. This treatment constitutes a tax expenditure because, under the benchmark system, these institutions are considered to be final consumers.

Other examples of tax rebates include the rebates for charities, substantially government-funded non-profit organizations, newly built housing and book purchases made by qualifying institutions. Also, foreign visitors to Canada are able to claim a rebate for the GST they pay on hotel accommodation and on goods they take home. Only the rebate for hotel accommodation is considered to be a tax expenditure, however, because goods taken home by foreign visitors are effectively exports which are not taxable under the benchmark system.

(iv) GST credit[2]

To ensure that the GST system is fair, a GST credit is provided through the personal income tax system to single individuals and families with low and moderate incomes. The credit is paid by cheque four times a year in equal instalments. The total amount of the credit people receive depends on family size and income and is calculated annually based on information provided in the personal income tax return.

GST tax expenditures:

- *zero-rated goods and services;*
- *tax-exempt goods and services;*
- *tax rebates; and*
- *tax credits.*

Memorandum items for the goods and services tax

As indicated earlier, some tax measures are presented as memorandum items even though they are not generally considered to be tax expenditures. For example, the refund of GST for certain employees' expenses is included as a memorandum item.

Many employees, such as commission salespeople, incur significant expenses in the course of carrying out their duties. Examples include restaurant meals and automobile expenses. Often, such expenses are not reimbursed by employers except indirectly through the salaries and commissions paid to employees. Since employees are not considered to be carrying on a commercial activity, they are not able to claim input tax credits for the GST they paid on these expenses. However, employees can receive a refund of the GST paid on those employment expenses that are deductible for income tax purposes. The refund of GST paid on

2 It should be noted that there was a small business transitional credit which accompanied the introduction of the GST. This temporary measure provided a one-time credit of up to $1,000 to GST registrants whose taxable sales did not exceed $500,000 in their first full quarter of 1991 or in any three-month period beginning in 1990.

employees' personal consumption expenses would constitute a tax expenditure. However, it is not possible to determine exactly what portion of these expenses should be considered personal consumption. Therefore, the refunds of GST paid on employees' expenses are reported as memorandum items. The memorandum items for the GST are discussed in more detail in Chapter 6.

Calculation and Interpretation of the Estimates

The estimates indicate the annual cash-flow impact to the government of each particular measure, and not their long-run or steady-state revenue cost, subject to the following limitations:

- all measures are evaluated independently; and
- all other factors remain unchanged.

These methodological distinctions are important and have implications for the interpretation of the estimates. These concepts are discussed in further detail below.

Independent estimates

The estimate of the cost of each tax expenditure is undertaken separately, assuming that all other tax provisions remain unchanged. An important implication of this is that the estimates cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

As explained in more detail in the following paragraphs, this restriction arises from the fact that:

- the income tax rate structure is progressive; and
- tax measures interact with one another.

Progressive income tax rates

The combined effect of claiming a number of income tax exemptions and deductions may be to move an individual to a lower tax bracket than would have applied had none of the tax measures existed. To the extent that this occurs, aggregation of the individual estimates may under-represent the "true" cost to the federal government of maintaining all of them. For example, consider a taxpayer whose taxable income was $1,000 below the level at which he or she would move from the 17-per-cent into the 26-per-cent tax bracket. Imagine that this taxpayer arrives at this level of taxable income by using two tax deductions of $1,000 each (e.g., home relocation loan and registered retirement savings plan (RRSP) contribution). Eliminating either deduction by itself would increase taxable income by $1,000 and the taxpayer's federal tax liability by $170. Eliminating both measures simultaneously, however, would not raise the tax liability by $170 + $170, but rather by $170 + $260.

Aggregating the individual estimates for these two items would provide a misleading impression of the revenue impact of eliminating both of them. Therefore, the estimates in this document cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

While there is only one statutory tax rate for corporations, the small business deduction creates a de facto progressive tax rate schedule for some corporations. In this way, the above argument is valid for the corporate income tax system as well, although the effect is not as large as for personal income taxes.

Interaction of tax measures

As noted above, the estimates are computed one at a time, assuming all other provisions remain unchanged. Given that tax provisions sometimes interact, the total cost of a group of tax expenditures calculated individually may differ from the dollar value of calculating the cost of the same group of tax expenditures concurrently. This is because adding the independently estimated costs of the tax provisions would result in double counting and so would not provide an accurate measure of the revenue which would be generated by simultaneously altering a group of measures.

For example, consider the non-taxation of veterans' allowances, which reduces the recipient's net income. Many measures, such as the medical expense credit, are calculated on the basis of net income. Thus, the reported estimate for the non-taxation of veterans' allowances represents not only the direct impact on government receipts of not taxing the allowances, but also the indirect impact of the change on the cost of other tax measures (such as the medical expense credit) which depend on net income.

Since estimates for GST tax expenditures are made using the same methodological approach as for income taxes, they too cannot be aggregated because they may interact. The following discussion of hospital rebates and zero-rating of prescription drugs illustrates the differences between independent and concurrent estimates for these two provisions.

- Eliminating hospital rebates: If hospital rebates were eliminated, hospitals would no longer be able to recover 83 per cent of the GST they pay on their purchases.[3] However, they could continue to purchase prescription drugs on a tax-free basis because these drugs are zero-rated. The estimate for hospital rebates recognizes that the rebate would not have been claimed in respect of zero-rated prescription drugs.

[3] Most services provided by hospitals are exempt from the GST. This means that no tax is charged on these services but input tax credits cannot be claimed to recover the tax paid on inputs. However, hospitals are able to claim a rebate of 83 per cent of the GST paid on the inputs they use to provide exempt services.

- Eliminating the zero-rating of prescription drugs: If prescription drugs were taxed at the GST rate of 7 per cent, then hospitals would pay the tax on their drug purchases but recover 83 per cent of the tax through the rebate system. Therefore, the estimate for the zero-rating of prescription drugs is calculated as net of the expected increase in the payment of hospital rebates.
- Eliminating the two measures concurrently has a revenue impact greater than the sum of the independent estimates because the GST would be payable on prescription drugs and hospitals would be unable to claim a rebate for these purchases.

Aggregation of estimates

The estimates for individual tax expenditures cannot be added together to determine the cost of a group of tax expenditures. There are two reasons for this:

- *the simultaneous elimination of more than one income tax expenditure would generate different estimates because of progressive income tax rates; and*
- *given the interaction of certain tax measures, the revenue impact of eliminating two or more measures simultaneously would differ from taking the independently estimated numbers published in this document and simply aggregating them.*

All other factors remain unchanged

The estimates in this report represent the amount by which federal tax revenues were reduced due to the existence of each preference assuming that all other factors remain unchanged.

In order to evaluate the extent of the revenue reduction, the approach taken here is to recalculate federal revenues assuming the measure in question has been eliminated. The difference between this recalculated figure and actual revenues provides the quantitative estimate of the cost of the tax expenditure.

The assumption that all other things remain the same means that no allowance is made for: (i) behavioural responses by taxpayers; (ii) consequential government policy changes; or (iii) changes in tax collections due to altered levels of aggregate economic activity which might result from the elimination of a particular tax measure (further detail is provided below). Incorporating these factors would add a large subjective element to the calculations.

(1) Absence of behavioural responses

In many instances, the removal of a tax expenditure would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay, perhaps by making greater use of other tax measures. Therefore, the omission of behavioural responses in the estimating methodology generates cost estimates which may exceed the revenue increases that would have resulted if a particular provision had been eliminated.

As one example, consider the case of the deduction for RRSP contributions. Eliminating this provision would result in the amount of additional federal revenue indicated in the report only if the contributions were not directed to an alternative tax-preferred form of saving. However, the absence of the RRSP deduction might encourage individuals to place their funds instead in some other tax-favoured instrument, such as shares in a labour-sponsored venture capital corporation. If such a response did occur, eliminating the RRSP deduction would result in a smaller increase in revenues than that indicated.

The effects of this assumption can also be illustrated for the GST by considering the housing rebate. Homeowners are eligible for a rebate of the GST they pay on the purchase of new houses. If this rebate were eliminated, the price of new houses would increase relative to the price of used houses. This, in turn, might reduce the demand for new houses while increasing the demand for used houses (which are tax exempt). Since the dynamics of the housing market are not taken into account, the revenues obtained by eliminating the housing rebate could actually be lower than the indicated estimate.

(2) Consequential government policy changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and take no account of other consequential changes in government policy. For example, if the government were to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates in this report do not provide for any such transitional relief.

Similarly, the estimates make no allowance for consequential government policy changes. For example, if capital gains on owner-occupied housing were made taxable under the personal income tax system, an argument could be made that the cost of maintenance should be deductible in the same way as other investment expenses. Furthermore, it may not be possible to track and assess small gambling winnings. This may mean that a threshold under which winnings would be non-taxable would be required. However, in calculating the cost of providing the exemption for lottery winnings, no allowance is made for such hypothetical consequential government policy changes.

(3) Impact on economic activity

The estimates do not take into account the potential impact of a particular tax provision on the overall level of economic activity and thus aggregate tax revenues. For example, although eliminating the low corporate tax rate for manufacturing and processing could generate a significant amount of revenue for the government, the amount of manufacturing activity could decline, resulting in possible job losses, a reduction in taxable income and, hence, a reduction in the aggregate amount of tax revenue collected. Furthermore, the derivation of the estimates does not include speculation on how the government might use the additional funds available to it and the possible impacts this could have on other tax revenues.

How to interpret the estimates

Each estimate in this report represents the amount by which federal tax revenues were reduced due to the tax expenditure assuming that all other factors remain unchanged. ***The estimates do not take into account changes in taxpayer behaviour, consequential government actions or feedback on aggregate tax collections through induced changes in economic activity. Accordingly, the elimination of a tax expenditure would not necessarily yield the full tax revenues shown in Tables 1, 2 and 3.***

Developing Historical Estimates

The majority of the personal income tax estimates in this report were computed with a personal income tax model. This model simulates changes to the personal income tax system using the statistical sample of tax returns collected by Revenue Canada for its annual publication *Taxation Statistics*. The model estimates the revenue impact of possible tax changes by recomputing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the moving expense deduction would result not only in a change in net income but also in all of the credits, such as the medical expense tax credit, whose values depend on net income. For those tax expenditures whose costs could not be estimated using this model alone, supplementary data were acquired from a variety of sources. Details on data sources and the methodologies used for estimating the cost of specific personal income tax measures are provided in Chapter 4.

A corporate income tax model was used to measure most of the corporate tax expenditures. As with the personal income tax model, it is based on a statistical sample of tax returns collected by Revenue Canada, and is able to recompute taxes payable on the basis of adjusted tax provisions. This recomputation of taxes takes into account the availability of unused tax

credits, tax reductions, deductions and losses that would be used by the corporation to minimize its tax liability. Where costs could not be estimated using this model alone, supplementary data acquired from a variety of sources were used. Details on these sources are provided in Chapter 5.

Estimating the cost of tax deferrals presents a number of methodological difficulties since, even though the tax is not currently received, it may be collected at some point in the future. It is therefore necessary to derive estimates of the cost to the government of providing such a tax deferral while at the same time ensuring comparability with the other estimates presented here.

In this report, income tax deferrals are estimated on a "current cash-flow" basis – that is, the cost is computed as the forgone tax revenue associated with the additional net deferral in the year (deductions for the current year less the income inclusion from previous deferrals). The estimates thus computed provide a reasonably accurate picture of the ongoing costs of maintaining a particular tax provision in a mature tax system. They can be aggregated over time without double counting and are comparable to estimates of the costs associated with tax credits and deductions.

The costs of the majority of the GST tax expenditures presented in this report were estimated using a Sales Tax Model based on Statistics Canada Input-Output Tables and the National Income and Expenditure Accounts. In cases where estimates were not derived using this model, supplementary data from a variety of sources were used. Details on both the data sources and methodologies are provided in Chapter 6.

Developing Future Projections

As with the historical estimates, the projections represent the estimated amount by which the federal tax revenues would be reduced due to the tax expenditure, assuming that all measures are evaluated independently. This means that the projections cannot be aggregated. In addition, it is assumed that all other factors remain unchanged. Thus, the projections make no provision for any behavioural change that might result from the removal of the provision; for any consequential policy changes that might accompany the change; or for the possible impact of the change on overall economic activity and thus on tax revenues. The projections do, however, take into consideration the impact of announced tax changes.

In contrast to the estimates of tax expenditures for the historical period, when values of the tax expenditures can generally be obtained from tax statistics or other historical data, projections of tax expenditures must rely on estimated relationships between tax expenditures and explanatory economic variables. Using these relationships, the values for the explanatory variables are projected into the future and so permit an estimation of the future expected values of tax expenditures. Key explanatory variables are generally those reflecting the state of the economy.

Projections for the explanatory variables are either based upon the 1998 budget forecasts (e.g., GDP, population, employment, corporate profits, inflation, consumer spending) or on past trends in the tax expenditure. Where projected tax expenditures were not obtained using these approaches, information on the alternative methodology is provided in Chapter 4 for personal income tax, Chapter 5 for corporate income tax and Chapter 6 for GST tax expenditures.

Any projections are inherently subject to forecast error, and quite substantial errors at times. Those familiar with forecasts prepared for the Canadian economy, or for any other economy, recognize that forecasting is not a science. Future values for key explanatory variables are based on best judgements and unchanged policies are assumed for the forecast period. Furthermore, the relationships between variables that are being explained and those that provide the explanation may not be robust and could quickly change over time. For all these reasons, the projected values of tax expenditures should be treated as "best efforts", which do not have any greater degree of reliability than the variables that explain them. For example, if the level of gross domestic product (GDP) explains a tax expenditure, one would not expect the projected level of tax expenditure to materialize if the expected level of GDP did not occur. Even if the expected level of GDP did materialize, the level of the tax expenditure might still not if, in the future, the relationship between the tax expenditure and GDP turns out to be different from that estimated on average in the past. Therefore, in general, one should expect that the degree of reliability of the projected tax expenditures should be less than that of the underlying explanatory variables.

Comparison With Direct Expenditures

In comparing the cost of the tax expenditures in this report to direct spending estimates, it should be noted that a dollar of tax preference is often worth substantially more to the taxpayer than a dollar of direct spending. This results from the fact that, in most cases, government grants (i.e. direct spending) are taxable to the recipients. For example, consider an individual facing a marginal tax rate of 29 per cent. A deduction of $100 would be worth $29. If, instead, the government were to provide the individual with a taxable grant of $29, after-tax income would increase by only $20.59 since he/she would face an income tax liability of $8.41 ($29 x 29 per cent).

The same conclusions do not always apply to tax expenditures provided to corporate taxpayers. Consider, for example, an investment tax credit to a corporation with respect to capital equipment acquired to carry out SR&ED in Canada. The cost to the government of providing a 20-per-cent tax credit would, in most circumstances, be the same as it would be if the government had provided a direct grant of 20 per cent. This is because investment tax credits are considered to be assistance and are therefore treated in the same manner as direct government grants or subsidies. The 20-per-cent tax credit, like a direct grant, is either included in income, and subject to corporate income tax, or it reduces the capital or other costs deductible by the taxpayer.

Chapter 4

Description of Personal Income Tax Provisions

The descriptions of the specific tax measures contained in this chapter are intended as a simplified reference and are not detailed descriptions of specific tax measures.

A number of measures which primarily affect corporations, but also unincorporated businesses, are treated in Chapter 5 on the corporate income tax measures.

Explanations of the methodologies used to produce estimates and projections are provided where they deviate from the standard approach of using the personal income tax simulation model described in Chapter 3.

Culture and Recreation

Deduction for clergy residence

A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct housing costs from income for tax purposes. Where a member of the clergy is supplied living accommodation by his/her employer or receives housing allowances, an offsetting deduction may be claimed to the extent that this benefit is included in income. The estimate for this item is based on the number of clergy in Canada and Statistics Canada expenditure data on rent.

Flow-through of CCA on Canadian films

Prior to 1995, the capital cost allowance (CCA) rate generally available on films was 30 per cent, subject to the half-year rule. On Canadian content films, the half-year rule did not apply. The CCA could be flowed through to investors and deducted against all sources of income. An additional allowance of up to the remaining undepreciated capital cost of the film was deductible against an investor's income from certified Canadian films.

Losses arising from CCA claimed at the partnership level and flowed through as limited partnership losses are included in the "Deduction of limited partnership losses" tax expenditure. It is estimated that 15 per cent of limited partnership losses relate to CCA on Canadian films.

The 1995 budget replaced the special tax shelter rules that applied to Canadian content films by a 12-per-cent credit that can be claimed only by certain film and video production corporations. Transitional rules for the 1995 taxation year allowed full deductibility of undepreciated capital cost against film income and the flow-through of the CCA to the investor only if the 12-per-cent refundable tax credit was not claimed in respect of the production.

Deduction for certain contributions by individuals who have taken vows of perpetual poverty

Where a person has taken a vow of perpetual poverty as a member of a religious order, that person may deduct donations to the religious order up to his/her total employment and pension income (but not investment or other income) in lieu of the charitable donations credit.

Write-off of Canadian art purchased by unincorporated businesses

Canadian art acquired by businesses for display in an office may be depreciated on a 20-per-cent declining-balance basis even though it may depreciate at a much slower rate, and may even appreciate.

No data are available.

Assistance for artists

Artists may deduct the costs of creating a work of art in the year the costs are incurred rather than in the year the work of art is sold.

Artists may also elect to value a charitable gift from their inventories at any amount up to its fair market value. This value is included in the artist's income. The percentage of income limit for the charitable donations tax credit does not apply.

No data are available.

Deduction for artists and musicians

Employed musicians are able to claim the cost of maintenance, rental, insurance and capital cost allowance on musical instruments against employment income earned as a musician.

Employed artists are also entitled to deduct expenses related to their artistic endeavours up to the lesser of $1,000 or 20 per cent of their income derived from employment in the arts.

No data are available.

Non-taxation of capital gains on gifts of cultural property

Certain objects certified as being of cultural importance to Canada are exempt from capital gains tax if donated to a designated museum or art gallery.

Such donations amounted to $101 million in 1994 and $99 million in 1995. However, there is no information on the portion of the value which represents capital gains.

Education

Tuition fee credit

A 17-per-cent tax credit is available for tuition fees paid by students to a prescribed educational institution. A credit is available with respect to fees paid to an institution if the total tuition fees paid to the institution exceed $100. The 1997 budget proposed to extend the credit to most mandatory ancillary fees imposed by post-secondary institutions, starting in 1997.

Education credit

Students who are enrolled at prescribed educational institutions on a full-time basis are entitled to claim a tax credit of 17 per cent of an education amount. The amount is $80 for every month of full-time attendance from 1993 to 1995, and $100 for 1996. The 1997 budget proposed that the amount be increased to $150 for 1997, and to $200 for 1998 and subsequent taxation years.

The 1998 budget proposes to extend this tax relief to part-time students for 1998 and subsequent years. Students enrolled at an educational institution in Canada in an eligible program lasting at least three consecutive weeks and involving a minimum of 12 hours of courses each month will be eligible. For each qualifying month, the education amount will be $60 per month on which the 17-per-cent tax credit will be provided.

Education and tuition credits transferred

The unused portions of the education and the tuition fee amounts may be transferred to a supporting spouse, parent or grandparent. The maximum transfer for the two credits combined is 17 per cent of $4,000 for taxation years 1993 to 1995 and of $5,000 for 1996 and subsequent taxation years.

Carry-forward of tuition and education credits

The 1997 budget proposes to allow students to carry forward indefinitely for their own use, education and tuition fee amounts that have not been either already used by the student or transferred to a supporting individual.

Student loan interest credit

In order to ease the burden of student debt, the 1998 budget proposes to provide a 17-per-cent non-refundable tax credit on the interest portion of student loan payments made in a year for 1998 and subsequent years. The credit may be claimed in the year in which it is earned or in any of the subsequent five years.

Exemption on first $500 of scholarship, fellowship and bursary income

The first $500 of scholarship, fellowship and bursary income is exempt from income tax.

The tax expenditures reported in the table are understated since no data are available on individuals receiving scholarship, fellowship or bursary income of less than $500.

Deduction of teachers' exchange fund contributions

Teachers may deduct up to $250 per year in contributions to a fund established by the Canadian Education Association for the benefit of teachers from Commonwealth countries visiting Canada under a teachers' exchange agreement.

Registered education savings plans

A taxpayer may contribute to a registered education savings plan (RESP) on behalf of a designated beneficiary (usually the taxpayer's child). Contributions to RESPs are not deductible, but are usually returned to the subscriber free of tax. The investment return on these funds is not taxable until it is withdrawn for the education of the named beneficiary. In 1993, 1994 and 1995, the annual contribution in respect of a beneficiary generally could not exceed $1,500 per beneficiary, with an overall limit of $31,500. Effective 1996, the annual limit was increased to $2,000 with an overall limit of $42,000.

The 1997 budget proposed to increase the annual limit to $4,000. It also proposed that, where beneficiaries of a plan are not pursuing higher education and a number of other conditions are met, the contributor be allowed to receive RESP income. In particular, beginning in 1998 a contributor would be allowed to roll over investment income to his/her registered retirement savings plan (RRSP) without penalty, subject to available RRSP room. Prior to 1998, RESP income could be used only for educational purposes, and was generally taxable in the hands of the beneficiary.

The 1998 budget proposes to supplement contributions to RESPs with a 20-per-cent grant, subject to annual and lifetime limitations, beginning January 1, 1998. While this enhancement does not directly represent a tax expenditure, it should increase the cost of the tax expenditure to the extent that it encourages participation in the RESP program.

No data are available. In light of the increasing importance of registered education savings plans, the 1997 budget indicated that Revenue Canada will require additional information from RESP trustees, including the amount of the funds accumulated in these plans.

Employment

Deduction of home relocation loans

For up to five years, an offsetting deduction from taxable income is provided for the benefit received by an employee in respect of a home relocation loan. The amount of the deduction is the lesser of the amount included in income as a taxable benefit and the amount of the benefit that would arise in respect of an interest-free loan of $25,000.

Non-taxation of allowances for volunteer firefighters

Volunteer firefighters were eligible to receive up to $500 per year in non-taxable allowances. The 1998 budget proposes to replace this measure with an exemption of up to $1,000 for amounts received by emergency service volunteers.

The estimates are based on census data.

Deduction for emergency service volunteers

The 1998 budget proposes to provide a tax exemption of up to $1,000 for amounts received by emergency service volunteers who, in their capacity as volunteers, are called upon to assist in emergencies or disasters.

Northern residents deductions

Individuals living in prescribed areas in Canada for a specified period may claim the northern residents deductions. The benefits consist of a residency deduction of up to $15 a day, a deduction for two employer-provided vacation trips per year, and unlimited employer-provided medical travel. Residents of the Northern Zone are eligible for full benefits, while residents of the Intermediate Zone are eligible for 50 per cent of the benefits.

The current definition of prescribed areas came into force in 1991. However, the implementation of the current system was gradual. Certain communities, which had qualified under the pre-1991 regime but which are no longer eligible under the current system received full benefits until 1992, two-thirds benefits in 1993, one-third benefits in 1994, and zero benefits thereafter. Communities in the Intermediate Zone which had qualified under the pre-1991 regime received full benefits until 1992, two-thirds benefits in 1993, and 50-per-cent benefits thereafter.

Overseas employment credit

A tax credit is available to Canadian employees working abroad for more than six months in connection with certain resource, construction, installation, agricultural or engineering projects. The credit is equal to the tax otherwise payable on 80 per cent of the employee's net overseas employment income taxable in Canada (up to a maximum income of $80,000).

Employee stock options

Provided certain conditions are met, the benefits provided by employee stock options (ESOs) are taxed at a preferential rate. A deduction equal to one-quarter the value of the benefit from the ESO is available to offset the tax liability on the option.

For employees of Canadian-controlled private corporations (CCPCs), the benefits accruing from ESOs are not generally included in income until the disposition of shares acquired with the options. However, the shares must be held for a minimum of two years to qualify for the one-quarter deduction.

For non-CCPCs, the benefit provided by an ESO must be included in income when the option is exercised.

Estimates presented in the table reflect the one-quarter deduction, but not the benefit from the deferred inclusion in income of benefits accruing under ESOs.

Non-taxation of strike pay

Strike pay is non-taxable.

Statistics Canada has ceased collecting information on the amount of strike pay.

Deferral of salary through leave of absence/sabbatical plans

Employees may be entitled to defer salaries through a leave of absence/sabbatical plan. Provided certain conditions are met by the plan, these amounts are not subject to tax until received.

No data are available.

Employee benefit plans

In certain circumstances, employers may make contributions to an “employee benefit plan” on behalf of their employees. The employee is not required to include in income the contributions to the plan or the investment income earned within the plan until amounts are received. Employers may not deduct these contributions to the plan until these contributions are actually distributed to the employees.

No data are available.

Non-taxation of certain non-monetary employment benefits

Fringe benefits provided to employees by their employers are not taxed when it is not administratively feasible to determine the value of the benefit. Examples include merchandise discounts, subsidized recreational facilities offered to all employees and special clothing.

No data are available.

Family

Spousal credit

A taxpayer supporting a spouse is entitled to a tax credit of 17 per cent of $5,380. This credit is reduced by 17 per cent of the amount by which the dependent spouse’s income exceeds $538.

Effective with the 1993 taxation year, the definition of spouse for tax purposes has been expanded to include common-law spouses, provided that the couple has lived together at least one year or has a common child.

Equivalent-to-spouse credit

An "equivalent-to-spouse" tax credit may be claimed in respect of a dependent child under age 18 or a parent or grandparent by taxpayers without a spouse. The amount of the credit and the limitation on the dependant's income are the same as for the spousal credit.

Infirm dependant credit

For taxation years 1993, 1994 and 1995, taxpayers could claim the dependant credit for dependent relatives over 17 years of age who were physically or mentally infirm. The credit was 17 per cent of $1,583 for dependants whose income was below $2,690. The credit was reduced by 17 per cent of the dependant's net income in excess of that amount and was exhausted when the dependant's net income exceeded $4,273.

Effective in the 1996 taxation year, the amount on which the credit is based is $2,353 and the credit begins to be phased out at $4,103.

Caregiver credit

The 1998 budget proposes to provide a caregiver tax credit of up to $400 for individuals residing with, and providing in-home care for, an elderly parent or grandparent or an infirm dependent relative. The credit amount will be reduced by the dependant's net income in excess of $11,500. This measure is effective for 1998 and subsequent years.

Child tax benefit

The child tax benefit (CTB) was introduced in 1993, replacing the family allowance, the dependant credit for children under 18 years of age and the refundable child tax credit. The child tax benefit payments are made monthly and are non-taxable.

The child tax benefit provides a basic credit of $1,020 per child annually, plus $75 for the third and each subsequent child. It also includes a supplement of $213 for each child under age 7, the total of which is reduced by 25 per cent of the child care expenses claimed. The total benefit is reduced by 5 per cent (2.5 per cent for one-child families) of family net income over $25,921.

The child tax benefit also includes a working income supplement for low-income working families. Until July 1, 1997, the working income supplement (WIS) was equal to 8 per cent of the family-earned income in excess of $3,750, reaching a maximum supplement of $500 at $10,000 of family earned income. The WIS was reduced by 10 per cent of the family net income in excess of $20,921.

The 1996 budget provided a two-step increase in the WIS, adding $125 million in July 1997 and an additional $125 million in July 1998. The 1997 budget proposed to enrich and restructure the WIS by providing benefits for each child, instead of a single benefit per family. The maximum benefit was increased from $500 per family to $605 for a first child, $405 for a second child and an additional $330 for the third and each subsequent child.

The WIS is phased in at annual family earnings of $3,750, reaching a maximum at $10,000 of family earned income. The WIS is reduced by 12.1 per cent of net family income in excess of $20,921 for one-child families, 20.2 per cent for a two-child family and 26.8 per cent for families with three or more children.

The proposed 1997 budget change enriched the WIS by $195 million in July 1997, $70 million more than the $125 million proposed for July 1997 in the 1996 budget. The CTB will be enriched further by $600 million and simplified to become the Canada Child Tax Benefit (CCTB) starting July 1, 1998, as part of a federal-provincial-territorial initiative to create a National Child Benefit System.

The 1998 budget announced the intention to enrich the CCTB by $425 as of July 1999 and a further $425 as of July 2000. Details of benefit increases will be determined in consultation with provincial and territorial partners and Canadians.

Deferral of capital gains through transfers to a spouse, spousal trust or family trust

Individuals may transfer capital property to their spouses or spousal trusts at the adjusted cost base of the property rather than the fair market value. This provides a deferral of the capital gain until the subsequent disposition of the property or until the transferee spouse dies.

Property transferred to other family members or to unrelated individuals (or to trusts of which they are beneficiaries) is treated differently. The transferor is generally deemed to have disposed of the property at the time of transfer at fair market value and must include any resulting capital gain in income at that time.

In the case of property transferred to a trust (other than a spousal trust), capital gains are generally considered to be realized at the time of the transfer on the basis of the fair market value of the property at that time. In addition, trust assets are generally subject to a deemed realization every 21 years at the fair market value of the assets. The 21-year deemed realization date was deferred to certain electing trusts. However, the 1995 budget eliminated this election and prevents any deferral of the 21-year realization beyond January 1, 1999.

Farming and Fishing

$500,000 lifetime capital gains exemption for farm property

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified farm property and qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gains exemption (where applicable) and the $500,000 lifetime capital gains exemption on small business shares have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Net Income Stabilization Account (NISA)

Farmers may deposit a percentage of a given year's eligible net sales, up to a limit, to their Net Income Stabilization Account (NISA). No tax deduction is given in respect of these deposits. Some of the deposits are matchable by the federal and provincial governments. Governments also pay a 3-per-cent interest bonus annually on the farmer's deposits which remain in the account. Governments' contributions and interest accrued in the account are not taxable until withdrawn. All withdrawals from the NISA are taxable except for the contributor's original deposits, which were made with after-tax dollars. Withdrawal entitlements from the NISA are triggered if the current year gross margin (net sales less eligible expenses) is less than the average gross margin from previous years (up to five), or if net income is below $10,000 (or $20,000 of family net income if the family held only one account).

The federal tax expenditure is a function of two components: the deferral of tax on the investment income accrued in the account and on government contributions to the account; and the income inclusion of these amounts when withdrawn from the account. The former has the effect of increasing tax expenditures, while the latter has the opposite effect. The estimates provided in the table are made on a current cash-flow basis – that is, they measure the impact on revenues of the tax measure in each of the years under consideration.

Deferral of income from destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

The estimates are based on data provided by Agriculture Canada.

Deferral of income on grain sold through cash purchase tickets

Under the cash purchase ticket program of the Canadian Wheat Board, farmers may make deliveries of grain before the year end and receive payment in the form of a ticket that may be cashed in subsequent years. The payment is included in income only when the ticket is cashed.

The estimates are based on data provided by the Canadian Wheat Board.

Deferral through 10-year capital gain reserve

If proceeds from a sale of a farm property to a child, grandchild or great-grandchild are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year, creating a maximum 10-year reserve period. For most other assets, the maximum reserve period is five years.

Deferral of capital gain through intergenerational roll-overs of family farms

Sales or gifts of assets to children, grandchildren or great-grandchildren typically give rise to taxable capital gains to the extent that the fair market value exceeds the adjusted cost base of the property. However, capital gains on intergenerational transfers of farm property are deferred in certain circumstances until the property is disposed of outside the immediate family.

No data are available.

Exemption from making quarterly tax instalments

Taxpayers earning business income must normally pay quarterly income tax instalments. However, individuals engaged in farming and fishing pay two-thirds of their estimated tax payable at the end of the taxation year and the remainder on or before April 30 of the following year.

No data are available.

Cash basis accounting

Individuals engaged in farming and fishing may elect to include revenues when received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income inclusion and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues, and expenses are deductible for the period to which they relate.

No data are available.

Flexibility in inventory accounting

Farmers using the cash basis method of accounting are allowed to depart from it with regard to their inventory. Under cash accounting, net additions to inventory are treated as a cost which is deducted in computing income. When inventory is increasing from year to year, such costs could create a loss for tax purposes. However, a discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farmers to avoid creating losses which would be subject to the time limitation if carried forward. The value of the tax expenditure is thus the amount of tax relief associated with the losses that would otherwise have been subject to the time limitations.

No data are available.

Federal-Provincial Financing Arrangements

Quebec abatement

Under the contracting-out arrangements which were offered to provinces in the mid-1960s for certain federal transfer programs, provinces could elect to receive part of the federal contribution in the form of a tax abatement. Quebec was the only province to elect this arrangement at the time and this has resulted in a 16.5-percentage-point abatement of federal tax for Quebec residents.

Transfers of income tax room to provinces

In 1967, the federal government transferred tax points to all provinces in place of certain direct cash transfers under the cost-shared program for post-secondary education. As a result, the personal income tax abatement was increased by 4 percentage points. In 1977, an additional 9.5 percentage points of individual income tax were provided to the provinces in respect of post-secondary, hospital insurance and medicare programs.

General Business and Investment

$100,000 lifetime capital gains exemption

The 1994 budget eliminated the $100,000 lifetime capital gains exemption (LCGE) for gains accrued after February 22, 1994. Accrued gains prior to that date were grandfathered. Individuals who had not disposed of their assets on that date were allowed to elect to claim the $100,000 LCGE on their 1994 tax return for gains accrued up to February 22, 1994. They were deemed to have disposed of their assets for an amount not exceeding their fair market value on that date.

The $100,000 LCGE applied in taxation years 1992 and 1993 and in 1994 for capital gains realized before February 22, 1994. The LCGE allowed individuals to exempt up to $100,000 in realized capital gains over their lifetime. The exemption was available only to the extent that the gains exceeded cumulative net investment losses incurred after 1987. The costs of tax expenditures associated with capital gains realized on exempt qualified farm property and exempt qualified small business shares are listed separately, even though some of these gains would qualify for the $100,000 lifetime capital gains exemption.

The 1992 budget eliminated the exemption for real estate gains accruing after February 1992 on property not used in an active business.

Partial inclusion of capital gains

Only three-quarters of net realized capital gains are included in income.

Deduction of limited partnership losses

A limited partner is able to deduct losses against other income up to the amount of investment at risk whereas a shareholder is normally not permitted

to deduct corporate losses against personal income. Unused losses may be carried back three years or forward seven years.

Limited partnership losses arise from a range of investments, from real estate investments to certified film productions. It is estimated that 15 per cent of this tax expenditure for years before 1995 is attributable to CCA claimed on Canadian films.

Investment tax credits

Tax credits are available for investments in scientific research and experimental development, exploration activities and certain regions. The tax credits range from 15 per cent to 45 per cent. The estimates treat the full investment tax credit as a tax expenditure even though tax credits reduce the capital cost of assets for CCA purposes and the adjusted cost base for capital gains purposes. A more detailed explanation is provided in Chapter 5.

Deferral through five-year reserve

If proceeds from a sale of capital property are not all receivable in the year of the sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds are received. A minimum of 20 per cent of the gain must be brought into income each year, creating a maximum five-year reserve period.

Deferral through capital gains roll-overs

In certain circumstances, taxpayers may defer the reporting of capital gains for tax purposes. General business roll-over provisions may be categorized into three groups:

Involuntary dispositions

Capital gains resulting from an involuntary disposition (e.g., insurance proceeds received for an asset destroyed in a fire) may be deferred if the funds are reinvested in a replacement asset within a specified period. The capital gain is taxable upon disposition of the replacement property.

Voluntary dispositions

Capital gains resulting from the voluntary disposition of land and buildings by businesses may be deferred if replacement properties are purchased soon thereafter (for example, a business changing location). The roll-over is generally not available for properties used to generate rental income.

Transfers to a corporation for consideration including shares

Individuals may transfer an asset to a corporation controlled by them or their spouses and elect to roll over any resulting capital gain or recaptured depreciation into the corporation instead of paying tax in the year of sale.

No data are available.

Deferral through billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

Deduction of accelerated tax depreciation

The depreciation allowable for tax purposes is called capital cost allowance (CCA). It may differ from true economic depreciation. A tax deferral may thus be created when the tax deductions in the early years of the life of an asset exceed the actual depreciation in the value of the asset. The difference is captured upon subsequent disposition of the asset.

The methodology for estimating this tax expenditure is explained in Chapter 5.

$1,000 capital gains exemption on personal-use property

Personal-use property is held primarily for the use and enjoyment of the owner rather than as an investment.

In calculating the capital gain on personal-use property, if the proceeds of disposition are less than $1,000, no capital gain needs to be reported. If the proceeds exceed this amount, the adjusted cost base (ACB) will be deemed to be a minimum of $1,000, thus reducing the capital gain in situations where the true ACB is less than $1,000.

No data are available.

$200 capital gains exemption on foreign exchange transactions

The first $200 of net capital gains on foreign exchange transactions is exempt from tax.

No data are available.

Taxation of capital gains upon realization

Capital gains are taxed upon the disposition of property and not when they accrue. This provides a tax deferral.

No data are available.

Health

Non-taxation of business-paid insurance benefits for group private health and dental plans

Employer-paid benefits for private health and dental plans are not taxable. The 1998 budget proposes to extend this measure to allow deductions from business income of self-employed persons for amounts paid for private health service plan coverage subject to certain restrictions.

The estimates are based on data from Statistics Canada and from an annual survey "Health Insurance Benefits in Canada", conducted by the Canadian Life and Health Insurance Association.

Disability credit

Canadians who are markedly restricted by disabilities in the carrying on of the basic activities of daily living are entitled to a tax credit. The credit is 17 per cent of $4,233. Any unused amount of the credit may be transferred to a supporting person.

Medical expense credit

Taxpayers are entitled to a 17-per-cent credit for eligible medical expenses incurred by the taxpayer, the taxpayer's spouse or by dependants. The credit is available in respect of expenses which exceed the lesser of 3 per cent of net income or $1,614. The 1998 budget proposes to allow supporting persons to claim the medical expense tax credit for training courses related to the care of dependent relatives with physical or mental infirmities

Medical expense supplement for earners

The 1997 budget proposed the creation of a refundable medical expense credit for low-income working Canadians with high medical expenses.

The new refundable credit supplements the assistance that is provided through the existing medical expense tax credit. The maximum refundable credit is the lesser of $500 and 25 per cent of eligible medical expenses. It is available to those individuals earning over $2,500, and is reduced by 5 per cent of net family income in excess of $16,069.

Income Maintenance and Retirement

The non-taxation of income-tested programs such as the guaranteed income supplement and provincial social assistance presents conceptual difficulties. The problems arise because, in many respects, these programs operate like an income tax in that eligibility for benefits is phased out after a certain income level. In this regard, excluding such benefits from income tax might not be considered a tax expenditure since they are subject to their own "tax".

On the other hand, a broadly based benchmark tax system would include such amounts in income. Given the comprehensive approach taken in this document, these items are considered to be tax expenditures.

Non-taxation of guaranteed income supplement and spouse's allowance benefits

The guaranteed income supplement (GIS) is an income-tested benefit payable to old age security (OAS) pensioners. Spouses of OAS recipients (or widows/widowers) between ages 60 and 64 may be eligible for the spouse's allowance (SPA). Benefits under both the guaranteed income supplement and spouses' allowance programs are non-taxable. Although GIS and SPA benefits must be included in income, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on data from Human Resources Development Canada and the personal income tax simulation model was developed by the Department of Finance from tax data.

Non-taxation of social assistance benefits

Social assistance benefits received by low-income Canadians must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such benefits from taxation while continuing to have them affect income-tested credits.

The estimates are based on data from Human Resources Development Canada and the personal income tax simulation model was developed by the Department of Finance from tax data.

Non-taxation of workers' compensation benefits

Workers' compensation benefits must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such benefits from taxation while continuing to have them affect income-tested credits.

Non-taxation of certain amounts received as damages in respect of personal injury or death

Amounts received in respect of damages for personal injury or death, and awards paid pursuant to the authority of criminal injury compensation laws are not taxable. In addition, investment income earned on personal injury awards is excluded from income until the end of the year in which the person reaches the age of 21.

The values reported in the tables understate the tax expenditure since they are based on awards paid by provinces' Criminal Injuries Compensation Boards only. No data were available for compensation awards paid by other sources, or regarding the investment income earned on awards by individuals under age 22.

Non-taxation of employer-paid premiums for group term life insurance of up to $25,000

Employer-paid premiums for group term life insurance coverage of up to $25,000 per employee paid before July 1, 1994 were not taxable.

The 1994 budget eliminated the tax exemption, effective July 1, 1994.

Non-taxation of veterans' allowances, civilian war pensions and allowances, and other service pensions (including those from Allied countries)

These amounts are not included in income for tax purposes.

The estimates are based on public accounts data.

Non-taxation of veterans' disability pensions and support for dependants

These amounts are not included in income for tax purposes.

The estimates for this item are based on public accounts data.

Treatment of alimony and maintenance payments

Payments by a taxpayer to a divorced or separated spouse are deductible to the payer and taxable in the hands of the recipient for agreements or awards made prior to May 1, 1997.

This treatment represented a tax expenditure because it departed from the benchmark system established for purposes of this report. Under this benchmark tax system, deductions are permitted only for expenses incurred in order to earn income and amounts received from other individuals are not included in the income of the recipient.

As of May 1, 1997, child support paid pursuant to a written agreement or court order made on or after that day will not be deductible to the payer nor included in the income of the recipient. Child support paid pursuant to a court order or written agreement made before that date will continue to be deductible to the payer and included in the income of the recipient, unless the agreement is varied. The tax changes do not apply to spousal support. Spousal support payments remain deductible by the payer and included in the income of the recipient.

The estimates for this item are computed as the value of the deduction to the payer less the tax collected from the recipient.

Age credit

Individual taxpayers age 65 or over are entitled to claim a tax credit of up to 17 per cent of $3,482. Unused portions may be transferred to a spouse. Starting in 1994, the age credit became subject to an income test. The age amount was reduced by 7.5 per cent of net income in excess of $25,921 in 1994, and by 15 per cent for 1995 and future years.

Pension income credit

A 17-per-cent tax credit is available on up to $1,000 of certain pension income. The unused portion of the credit may be transferred to a spouse.

Saskatchewan Pension Plan

Contributions to the Saskatchewan Pension Plan are deductible up to the lesser of $600 or the amount of unused RRSP room in a particular year.

Registered pension plans/registered retirement savings plans

The federal revenue forgone due to the provisions pertaining to registered retirement savings plans (RRSPs), registered pension plans (RPPs) and deferred profit-sharing plans (DPSPs) is a function of three components: the deductibility of contributions to such plans; the non-taxation of investment income accrued within such plans; and the income inclusion of RPP/RRSP withdrawals which reduces the cost resulting from the previous two. Individuals benefit from a deferral of tax on amounts contributed and on investment income. Also, there is an absolute tax saving to the extent that the tax rate on withdrawals is below that faced at the time of contributions. That is, many contributors are in a higher tax bracket during their working lives than when they are retired.

As noted in Chapter 3, the estimates provided in the table are made on a current cash-flow basis – that is, they measure the impact on revenues of the tax measure in each of the years under consideration. The Auditor General has recommended that the estimates for registered pension plans and registered retirement savings plans be provided on a present value basis as well as the current cash-flow estimates. Work is proceeding on developing such estimates, although they are not yet ready to be included in this year's report.

In 1991, a new system of comprehensive limits on tax-assisted retirement saving took effect. Under this system, saving in RRSPs, RPPs and DPSPs is governed by a comprehensive limit of 18 per cent of earnings up to a dollar amount. In more detail, the limits are as follows.

- For defined benefit pension plans, the limits are the same as in 1990 – that is, there are no fixed limits on employee contributions while employer contributions are restricted to the amounts necessary to fully fund the promised benefits. Annual pension benefits under these pension plans are limited to the lesser of $1,722 and 2 per cent of earnings for each year of pensionable service.
- For RRSPs, contributions are limited to 18 per cent of earned income for the preceding taxation year up to a dollar maximum ($12,500 for 1993, $13,500 for 1994, $14,500 for 1995, $13,500 from 1996 to 2003), minus a pension adjustment (PA). The PA is based on RPP or DPSP benefits earned by plan members in the previous taxation year. For a money purchase RPP or a DPSP, the PA is simply the total contribution made by, or on behalf of, a plan member in the year. For a defined benefit RPP, the PA is a measure of the benefits earned in the year, calculated according to a prescribed formula.

In 1992, the federal government introduced the Home Buyers' Plan as a temporary measure. It allowed all individuals to withdraw up to $20,000 from their RRSPs on a tax-free basis to purchase a home. Amounts withdrawn under the Home Buyers' Plan are to be repaid to the individual's RRSP on an interest-free basis over a period of 15 years. Amounts that are not repaid are included in the individual's income for tax purposes. In 1994, this measure was made permanent, but restricted to first-time home buyers only. The 1998 budget proposes to allow persons eligible for the disability tax credit to participate in the Home Buyers' Plan more than once in the individual's lifetime. The funds must be used to purchase a home that is more accessible for, or better suited for, the care of the individual. The impact of the Home Buyers' Plan on the cost of RRSPs is expected to be small.

The 1998 budget proposed to allow individuals to make tax-free RRSP withdrawals for lifelong learning, subject to certain restrictions. Individuals will have to repay these amounts over a fixed period of time. In many ways, this program parallels the Home Buyers' Plan.

It should be noted that the RRSP/RPP estimates do not reflect a mature system because contributions currently exceed withdrawals. Assuming a constant tax rate, if contributions equalled withdrawals, only the non-taxation of investment income would contribute to the net cost of the tax expenditure. As time goes by and more retired individuals have had the opportunity to contribute to RRSPs throughout their lifetime, the gap between contributions and withdrawals will shrink and possibly even become negative. The upward bias in the current cash-flow estimates can therefore be expected to decline.

The estimates may not reflect the benefit to a particular individual in any given year because the individual is typically either a contributor or withdrawer at a point in time but not both. In order to estimate the benefit to a particular individual, one could calculate the difference in disposable income between a situation in which that individual invests in an RRSP/RPP and one in which that individual invests in a non-sheltered savings instrument.

Data used to estimate the value of these measures were taken from the personal income tax model, unpublished data from Statistics Canada, and from Statistics Canada publications *Trusteed Pension Funds* (Cat. 74-201) and *Pension Plans in Canada* (Cat. 74-401), as well as from the *Bank of Canada Review.*

Deferred profit-sharing plans

Employers may make tax-deductible contributions to a profit-sharing plan on behalf of their employees. These amounts are taxable in the hands of the employees when withdrawals are made from the plan. The employer's contribution cannot exceed one-half of the money purchase RPP dollar limit for the year ($6,750 in 1993 and $7,250 in 1994 to 2003) or 18 per cent of the employee's earnings. The amount is included in the PA for the taxpayer. The taxpayer's total PA (for both RPP and DPSP contributions) cannot exceed the money purchase RPP dollar limit for the year ($13,500 for 1993 and $14,500 for 1994 to 2003).

No data are available.

Non-taxation of RCMP pensions/compensation in respect of injury, disability or death

Pension payments and other compensation received in respect of an injury, disability or death associated with service in the Royal Canadian Mounted Police are non-taxable.

No data are available.

Non-taxation of up to $10,000 of death benefits

Up to $10,000 of death benefits paid by an employer to the spouse of a deceased employee is non-taxable.

No data are available.

Non-taxation of investment income on life insurance policies

The investment income earned on some life insurance policies is not taxed as income to the policyholder. Instead, for reasons of administrative convenience, insurance companies are subject to tax on such earnings.

(See Chapter 5 for a further description of this measure and estimates of the cost of the tax expenditure involved.)

Small Business

$500,000 lifetime capital gains exemption for small business shares

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gains exemption (where applicable) and the $500,000 lifetime capital gains exemption on qualified farm property have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Deduction of allowable business investment losses

Under the benchmark system, capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, three-quarters of capital losses in respect of shares or debts of a small business corporation (allowable business investment losses) may be used to offset other income. Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

The estimated tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year. The tax expenditure is overestimated since it does not reflect the future reduction in tax revenues that would occur if those losses were instead deducted from future capital gains.

Labour-sponsored venture capital corporations credit

A tax credit is provided to individuals for the acquisition of shares of labour-sponsored venture capital corporations. For shares acquired before March 6, 1996, the rate of the federal credit was 20 per cent to a maximum credit of $1,000. For shares acquired after March 5, 1996, the rate of the federal tax credit is 15 per cent, to a maximum credit of $525.

Deferral through 10-year capital gain reserve

If proceeds from the sale of small business shares to children, grandchildren or great-grandchildren are not all receivable in the year of sale, recognition of a portion of the capital gain realized may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year creating a maximum 10-year reserve period. This contrasts with the treatment of most other property where the maximum reserve period is five years.

Other Items

Non-taxation of capital gains on principal residences

Capital gains realized on the disposition of a taxpayer's principal residence are non-taxable. The capital gains were determined using Multiple Listing Service (MLS) housing prices, adjusted to include expenditures on capital repairs and major additions and renovations, obtained from Statistics Canada's Consumer Expenditure Survey. The holding period for principal residences was derived from 1981 Census data.

Estimates for this item are provided for both partial and full inclusion rates for capital gains.

Non-taxation of income from the Office of the Governor General

This income is exempt from personal income taxation.

Data were provided by the Office of the Governor General.

Assistance for prospectors and grubstakers

Where a prospector or grubstaker disposes of mining property to a corporation in exchange for shares in that corporation, the tax liability is deferred until the subsequent disposition of the shares. At that time, only three-quarters of the amount for which the mining property was transferred to the corporation need be included in income.

Charitable donations credit

Donations of up to 50 per cent of net income for taxation year 1996 (20 per cent prior to 1996) made to registered charities qualified for the charitable donation credit in the year. The 1997 budget proposed to further increase the limit for 1997

and subsequent years to 75 per cent of net income. Provision was made in 1996 and maintained in the 1997 proposals to ensure that no short-term tax liability would arise from the realization of capital gains on donations of appreciated assets. The 1997 proposals extended this treatment to any capital cost allowance recapture arising from the donation of depreciable capital property. Donations in excess of the limit may be carried forward for up to five years. The percentage of income restriction does not apply to certain gifts of cultural property nor, beginning in 1995, to donations of ecologically sensitive lands.

The credit is 17 per cent on the first $200 ($250 prior to 1994) of total donations (including gifts to the Crown) and 29 per cent on donations in excess of $200 ($250 prior to 1994).

Reduced inclusion rate for capital gains arising from certain charitable donations

The 1997 budget proposed to reduce the inclusion rate on capital gains arising from certain donations by individuals or corporations to charities (other than private charitable foundations) from 75 per cent to 37½ per cent. Eligible donations would be those of securities that are listed publicly on a recognized stock exchange in Canada, where the donation is made between February 18, 1997 and the end of the year 2001.

Gifts to the Crown credit

A tax credit is available for gifts to the Crown. The credit is 17 per cent on the first $200 ($250 in 1993) of total donations (including charitable donations) and 29 per cent on donations in excess of $200 ($250 in 1993). Prior to 1997, tax credits arising from gifts to the Crown could be used up to reduce taxes on up to 100 per cent of income.

The 1997 budget proposed to restrict this to 75 per cent of income for 1997 and subsequent years. The limit would also be increased by 25 per cent of the amount of taxable capital gains arising from the donations of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property. Donations of ecologically sensitive land and certain gifts of cultural property are exempt from the net income limit. The limit does not apply to gifts in the year of death and the preceding year. Unused contributions may be carried forward for up to five years.

Political contribution credit

A credit is available for donations to registered federal political parties. The credit is 75 per cent of the first $100 of contributions, 50 per cent on the next $450 of contributions and 33⅓ per cent on the next $600. The maximum credit claimable in any year is $500.

Non-taxation of income of Indians on reserves

Section 87 of the *Indian Act* exempts the personal property of a status Indian and Indian bands from taxation if such personal property is situated on a

reserve. Courts have held that the term “personal property” includes income. Determining whether income is situated on reserve requires an examination of the factors that connect it to a reserve. With respect to employment income, for example, a key factor is the location (on or off a reserve) at which the employment duties were performed.

No data are available.

Non-taxation of gifts and bequests

Gifts and bequests are not included in the income of the recipient for tax purposes.

No data are available.

Memorandum Items

Non-taxation of lottery and gambling winnings

Lottery and gambling winnings are excluded from income for tax purposes.

The estimate for the non-taxation of winnings in government lotteries is based on information provided by Statistics Canada. Values for the non-taxation of winnings from horse racing are estimated using data provided by Agriculture Canada. The values do not include winnings from other types of gambling, such as bingo and casino winnings where no accurate data are available.

The tax expenditure estimate assumes that the total amount of lottery and horse racing winnings would be included in income and subject to tax. This would likely not be the case because there would be a large administrative cost in taxing thousands of small prizes, in particular instant win lotteries. A threshold below which winnings would be non-taxable would result in substantially lower revenues than the figure published in this report.

It should also be noted that proceeds from the sale of lottery tickets are an important source of funds for provincial governments and not-for-profit organizations. As a result, there is already a considerable element of taxation to lottery and gambling proceeds.

This estimate is therefore included as a memorandum item only.

Non-taxation of specified incidental expenses

Members of Parliament (MPs), Members of Legislative Assemblies (MLAs), Senators and some other public officials (such as elected municipal officials and judges) receive flat allowances for expenses incidental to their duties. These amounts are not included in income for tax purposes.

This provision is a memorandum item because it is not possible to distinguish the proportion of these allowances which is used for personal consumption and that which is for work-related expenses.

Data are available only for the non-taxable allowances provided to MPs, MLAs and Senators. This information is found in the publications *Canadian Legislatures* and *The Canadian Parliamentary Guide.*

Non-taxation of allowances for diplomats and other government employees posted abroad

Diplomats and other government employees posted abroad receive an allowance to cover the additional costs associated with living outside Canada. These allowances are not taxable.

Information on total allowances was obtained from Treasury Board.

Child care expense deduction

Child care expenses incurred for the purpose of earning business or employment income, taking an occupational training course or carrying on research for which a grant is received are deductible, up to a limit. Prior to 1998, the deduction could not exceed the lesser of $5,000 per child if the child was under age 7 or was disabled plus $3,000 per child between 7 and 14 years of age (16 years after 1995); two-thirds of earned income for the year; and the actual amount of child care expenses incurred. The two-thirds earned income limit does not apply to single parent students after 1995. The deduction must generally be claimed by the spouse with the lower income. However, the higher-income parent may claim a deduction if the lower-income parent is infirm, confined to a bed or a wheelchair, in prison, or attending a designated educational institution on a full-time basis.

The 1998 budget proposes to enhance the child care expense deduction by increasing the deduction limits by $2000 to $7000 for children under age 7 or disabled and $1000 to $4000 for older children. The budget also proposes to allow child care expenses incurred by an individual in order to pursue part-time education to be claimed, subject to certain limits.

Attendant care expense deduction

A disabled individual can deduct the cost of unreimbursed care provided by a part-time attendant, if such an expense is required to enable the individual to work. For taxation years 1993 to 1997, the deduction cannot exceed the lesser of $5,000 and two-thirds of earned income for the year. The 1997 budget proposed to eliminate the limit on attendant care expenses.

Moving expense deduction

All reasonable moving expenses incurred to earn employment or self-employment income at a new location (e.g., transportation, meals and temporary accommodation, cost of selling a former residence) are deductible from earnings or business income received after the move if the taxpayer moves at least 40 kilometres closer to the new place of employment or study. The deduction has to be claimed in the year, or in the following year if it exceeds earnings at the new location in the year of the move.

Prior to 1998, moving expense reimbursements provided by employers are not included in income. The 1998 budget proposed to include certain employer-provided reimbursements in income, and to allow an offsetting deduction to the same extent as permitted for self-paid expenses. The 1998 budget also proposed to expand the definition of relocation costs eligible for deduction.

The estimates do not include non-taxable reimbursements received from employers.

Deduction of carrying charges incurred to earn income

Interest and other carrying charges, such as investment counselling fees and safety deposit box charges, incurred to earn business or investment income are deductible.

Some might consider the deductibility of such expenses to be a tax expenditure because of the tax deferral arising from the up-front deduction of expenses associated with the earning of income which will not be taxed until received possibly in future years. Others would hold that carrying charges are incurred for the purpose of earning income and therefore represent part of the benchmark income tax system.

Deduction of meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 50 per cent of the cost of food, beverages and entertainment (80 per cent before March 1, 1994). Where the cost of food, beverages or entertainment is part of a package price which includes amounts not subject to the 50-per-cent limitation – for instance, the fee for a conference – the taxpayer is required to determine the value or make a reasonable estimate of the amount subject to the 50-per-cent limitation.

Deduction of farm losses for part-time farmers

Individuals whose major source of income is not farming are allowed to deduct farm losses against other income up to an annual maximum of $8,750.

Part-time farm losses that are not deductible in the current year may be carried back three years and forward 10 years to deduct against farm or non-farm income. The estimates include the cost of these carry-overs.

Farm and fishing loss carry-overs

Farm and fishing losses may be carried back three years and forward 10 years. Most other business losses may be carried forward only seven years.

The only data that are available are prior years' losses carried forward to the current year. In this regard, the estimates do not include current year losses carried forward or back to other taxation years, nor do they include future losses carried back to the taxation year in question. The estimates do not include losses carried over by part-time farmers.

Capital loss carry-overs

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. The estimates do not include current year losses carried forward or back to other taxation years nor do they include future losses carried back to the taxation year in question.

Non-capital loss carry-overs

Non-capital losses may be carried back three years and forward seven years to offset other income.

The only data which are available are prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost estimates may understate the true amount of revenue forgone because they do not include current year losses carried forward or back to other taxation years nor do they include future losses carried back to the taxation year in question.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of two-thirds of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province.

The estimates are based on data from Revenue Canada.

Deduction of resource-related expenditures

Individuals are entitled to deduct certain expenses associated with the exploration for, and development of, Canadian natural resources. These expenses are deductible if the taxpayer either engages directly in these resource activities or provides financing to a resource company which, in turn, "flows through" the tax deductions to the taxpayer.

A tax expenditure arises when a flow-through share investor is able to use deductions for exploration and development more quickly than would otherwise have been possible by the resource company that actually undertook these expenditures. This may be because the taxpayer has otherwise-taxable income in a year and the corporate issuer of the flow-through does not. It may also be the direct result of a special provision for junior oil and gas companies whereby expenses that would otherwise be deductible at 30 per cent can be deducted at 100 per cent when "flowed through" using flow-through shares.

However, the available data do not permit a separation of expenses that are flowed through to investors and those that are incurred directly by the taxpayers. Accordingly, only some portion of resource-related expenditures deducted represents a true tax expenditure. Consequently, the total cost of all these deductions has been calculated, but these amounts are treated as a memorandum item.

Deduction of other employment expenses

Employee expenses are generally not deductible. However, specific employment expenses (e.g., automobile expenses, cost of meals and lodging for certain transport employees, legal expenses paid to collect salary) are deductible in certain circumstances in the computation of income.

This provision is a memorandum item because it is not possible to distinguish the proportion of these expenses which is used for personal consumption and that which is incurred in order to earn income.

Deduction of union and professional dues

Union and professional dues are fully deductible from income.

The mandatory nature of these payments leads to their classification as expenses to earn income.

Employment insurance contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for employment insurance contributions. Employer-paid premiums are not included in the employee's income.

The mandatory nature of employment insurance contributions leads to their classification as expenses incurred to earn income.

Canada and Quebec Pension Plan contribution credit/ non-taxation of employer-paid premiums

A 17-per-cent tax credit is provided for Canada/Quebec Pension Plan contributions by both employees and the self-employed. Employer-paid premiums are not included in the employee's income.

Again, since CPP/QPP contributions are mandatory, they are classified as expenses incurred to earn income.

Foreign tax credit

In order to avoid double taxation, a tax credit is provided in recognition of income taxes paid in foreign countries.

Dividend gross-up and credit

Dividends received from taxable Canadian corporations are "grossed up" by a factor of one-quarter and included in income. A tax credit equal to 13.33 per cent of the grossed-up amount is then provided, in recognition of taxes paid at the corporate level. These provisions contribute to the integration of the corporate and personal income tax systems.

Supplementary low-income credit

The 1998 budget proposes to provide a supplement of $500 to the basic personal, spousal and equivalent-to-spouse non-refundable tax credits for low-income taxfilers. The supplementary amount for a single individual will be reduced by 4 per cent of income in excess of $6,956. The total amount available to an individual with an eligible dependant will be reduced by 4 per cent of the filer's income minus the total of $6,956 and the dependant's adjusted income.

Basic personal credit

All taxpayers qualify for a basic personal credit equal to 17 per cent of $6,456.

Non-taxation of capital dividends

Private corporations may distribute the exempt one-quarter of any realized capital gains accumulated in their "capital dividend account" to their shareholders in the form of a capital dividend. This dividend is non-taxable. This measure is reported as a memorandum item since it contributes to the integration of the taxation of corporate and personal income.

No data are available.

Chapter 5

Description of Corporate Income Tax Provisions

The descriptions of the specific tax measures contained in this chapter are intended as a simplified reference and are not detailed descriptions of specific tax measures.

Many of the estimates and projections are provided using the corporate income tax micro-simulation model, which has been developed jointly with Revenue Canada.

Tax Rate Reductions

The following items are measures that reduce the statutory tax rate faced by a corporation. They are considered to be tax expenditures because income is taxed at a rate other than the generally applicable tax rate.

Low tax rate for small businesses

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for a small business tax rate reduction, known as the small business deduction. This deduction lowers the basic federal tax rate on the first $200,000 of active business income of CCPCs by 16 percentage points – from 28 per cent to 12 per cent.

Some larger CCPCs are ineligible for the small business deduction. Effective July 1, 1994, CCPCs with more than $15 million of taxable capital employed in Canada are no longer eligible for this rate reduction. In addition, CCPCs with between $10 million and $15 million of taxable capital employed in Canada have reduced access to the small business deduction.

Low tax rate for manufacturing and processing

Canadian manufacturing and processing (M&P) income not eligible for the small business deduction is subject to a reduced tax rate, known as the manufacturing and processing profits deduction. This deduction lowers the basic federal tax rate on eligible income earned after 1993 by 7 percentage points – from 28 per cent to 21 per cent.

For years prior to 1994, the manufacturing and processing profits deduction was lower:

- for 1993, the reduction was 6 percentage points, thereby reducing the basic federal tax rate on eligible income from 28 per cent to 22 per cent; and
- for 1992, the reduction was 5 percentage points, thereby reducing the basic federal tax rate on eligible income from 28 per cent to 23 per cent.

Low tax rate for credit unions

Although not a private corporation for most purposes, a credit union is eligible for the small business deduction (i.e. 16 per cent of its taxable income). A credit union with more than $200,000 of active business income may be eligible for a deduction of 16 per cent of its taxable income where the total income of the corporation since 1971 is less than the corporation's "maximum cumulative reserve", which is equal to 5 per cent of amounts owing to members (including members' deposits and share capital). The purpose of this additional deduction is to permit a credit union to accumulate capital on a tax-preferred basis up to a maximum of 5 per cent of deposits and capital.

Exemption from branch tax for transportation, communications, banking and iron ore mining corporations

The branch tax is imposed on that portion of the income of non-resident corporations derived from the carrying on of business in Canada through a branch. If a Canadian branch has ceased active business operations, non-residents are liable for tax on capital gains on dispositions of taxable Canadian property. The rate is 25 per cent, but is frequently reduced by bilateral tax treaties to 15 per cent, 10 per cent or 5 per cent.

A corporation is exempt from the branch tax if it is:

- a bank;
- a corporation whose principal business is:
  - the transportation of persons or goods,
  - communications, or
  - mining iron ore in Canada; or
- an exempt corporation such as a registered charity.

No data are available.

Exemption from tax for international banking centres

A prescribed financial institution's branch or office carrying on certain business in the cities of Montreal or Vancouver may qualify as an international banking centre (IBC) and therefore be exempt from tax on its income. To qualify as an IBC under the *Income Tax Act*, the branch's income must be derived from accepting deposits and making loans to non-residents. This measure, introduced in 1987, is considered a tax expenditure because a financial institution can undertake business with non-residents through a Canadian permanent establishment without being subject to Canadian income taxes.

No data are available.

Tax Credits

Investment tax credits

The following measures are credits against federal income taxes otherwise payable. They are considered to be tax expenditures because they provide incentives to taxpayers which invest in certain activities, such as scientific research and experimental development (SR&ED), or in certain capital assets in designated regions of the country.

The amount of an investment tax credit (ITC) is calculated as a percentage of the cost of eligible expenditures. ITCs can reduce federal income tax revenues in one of two ways. They may be:

- used to offset federal income taxes otherwise payable; or
- fully or partially refunded in the year they are incurred in the case of smaller CCPCs.

Prior to 1994, there was a limitation on the amount of ITCs that could be utilized in a taxation year. Specifically, in most cases, ITCs could only be used to offset up to 75 per cent of a taxpayer's federal income tax and surtax otherwise payable. For CCPCs, a special rule permitted the full offset of federal tax on their business income eligible for the small business deduction. The annual ITC limitation had been introduced to reduce the number of large corporations that were profitable, but did not pay income tax. However, as announced in the 1993 budget, the introduction of the large corporations tax eliminated the need for the annual ITC limitation and investment tax credits became fully deductible for all taxpayers for taxation years beginning after 1993.

Certain ITCs earned in a year may be refunded to individuals and qualifying corporations that cannot use them to reduce federal income taxes otherwise payable. The rate of refundability for these ITCs is generally 40 per cent. However, a qualifying CCPC may receive a refund of 100 per cent on SR&ED ITCs earned at the 35-per-cent rate in respect of up to $2 million of eligible current expenditures.

Prior to 1994, a qualifying corporation for purposes of the refund was generally a CCPC with taxable income not exceeding $200,000 in the preceding year. However, the 1993 budget modified this rule in the case of the SR&ED ITC so that, after 1993, refundability phases out as the prior-year taxable income of a CCPC (or associated corporate group) rises above $200,000 and is eliminated entirely at $400,000. This change was made to reduce the negative consequences of exceeding the $200,000 limit by even a small amount. The change eases the transition between the start-up phase and the period of expansion that small businesses typically experience and provides more certainty to their business planning. In order to focus ITC benefits to smaller CCPCs, the 1994 budget introduced a further change to phase out refundability after 1995 for CCPCs with taxable capital employed in Canada exceeding $10 million and to fully eliminate refundability for CCPCs with taxable capital employed in Canada exceeding $15 million.

All refunds reduce the amount of ITC for carry-over purposes. Unused ITCs may be carried forward 10 years or back three years.

ITCs utilized or refunded in a year reduce either the undepreciated capital cost of the asset for capital cost allowance (CCA) purposes or, in the case of SR&ED, the SR&ED pool. Credits earned in respect of a property acquired after 1989, and not immediately available for use may not become claimable or refundable until the property is available for use or has been held by the taxpayer for two years.

Issues in calculating the value of ITCs

To maintain consistency with the other estimates in this document, the amounts reported in the table estimate the forgone revenue for the year in question from each ITC. In other words, the estimates show how much additional revenue would have been collected by the government in the year if the ITC had been eliminated in that particular year. To do this, the amount of ITCs used in the year are separated into two components: ITCs that were both earned and used in the year, and ITCs that were earned in prior years, but carried forward and used in the year. The former represents credits in respect of current year expenditures. The costs of any applicable refunds of ITCs earned are included in these estimates. The latter item – ITCs earned in past years but not used until the current year – is itemized separately as an aggregate for all ITCs.

Another perspective on the revenue cost of each ITC may be obtained by looking at the amount of ITCs earned in a specific year. This information is provided in the following table for 1993 and 1994. However, it should be recognized that ITCs earned in the year are not necessarily used in the year – they may be used in a subsequent or previous year, subject to the carry-over rules. As a result, had the ITCs been eliminated, government revenues for the year would not have been higher by the amounts shown in the following table since it may take a number of years for ITCs earned in a year to be used by the taxpayer to reduce federal taxes.

Investment tax credits earned in the year

	1993*	1994
	($ millions)	
SR&ED ITC	1,370	1,483
Atlantic ITC	124	152
Special ITC	48	119
Cape Breton ITC	S	0
Small business ITC	228	203

* These 1993 figures are based on final data and may differ from the figures in last year's edition of this document which were based on preliminary data.

SR&ED investment tax credit

There were three rates of SR&ED ITC prior to 1995: a general rate of 20 per cent; an enhanced rate of 35 per cent for CCPCs with prior-year taxable income of less than $200,000; and a rate of 30 per cent for the Atlantic provinces and the Gaspé region. The latter rate was eliminated in the 1994 budget effective after 1994. The maximum amount of SR&ED expenditures that can earn ITCs at the 35-per-cent rate in a year is $2 million.

The SR&ED ITC is earned on eligible current and capital expenditures in respect of SR&ED in Canada performed by, or on behalf of, a taxpayer and related to a business of the taxpayer.

Atlantic investment tax credit

Prior to 1995, the Atlantic investment tax credit (AITC) was available at a rate of 15 per cent in respect of eligible expenditures in the Atlantic region – i.e. Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, the Gaspé region and their associated offshore areas. The 1994 budget reduced the AITC rate to 10 per cent for eligible expenditures incurred after 1994.

The AITC is earned on eligible expenditures on new buildings, machinery and equipment employed in the following qualifying activities: farming, fishing, logging, mining, oil and gas, and manufacturing and processing.

The AITC is refundable at a rate of 40 per cent for qualifying CCPCs and individuals.

Special investment tax credit

Prior to 1995, the special investment tax credit (SITC) was provided at a rate of 30 per cent for eligible expenditures on new buildings, machinery and equipment used in qualifying activities in qualifying regions of Canada. The SITC was eliminated in the 1994 budget, effective January 1, 1995. However, certain activities in the Atlantic region continue to be eligible for the AITC.

Qualifying activities were defined under the *Regional Development Incentives Act* and its regulations, and generally included manufacturing and processing facilities located in a qualifying region with the exception of certain primary processing of natural resources.

Qualifying regions included north-eastern British Columbia, north-western Alberta, northern Saskatchewan, most of Manitoba, northern Ontario, northern Quebec and the Gaspé region, and areas of Atlantic Canada.

Cape Breton investment tax credit

The Cape Breton investment tax credit was applicable to eligible expenditures on new buildings, machinery and equipment acquired for use in qualifying activities in Cape Breton after May 23, 1985 and before 1993. The original rate of 60 per cent was reduced to 45 per cent after 1988.

Small business investment tax credit

The small business investment tax credit was available at a rate of 10 per cent for eligible expenditures on machinery and equipment acquired after December 2, 1992 and before 1994 by unincorporated businesses, partnerships and CCPCs, other than those subject to the large corporations tax. The credit was not refundable.

ITCs claimed in current year but earned in prior years

These are tax credits that were earned by corporations in previous years but not claimed until the current year. There is a revenue cost to the government when the credits are used by corporations to reduce federal taxes payable. While the aggregate amount of these credits is known with some confidence, there is not enough information available to identify separately the amounts for each credit.

Political contribution tax credit

A non-refundable tax credit is available for contributions to registered federal political parties or candidates. The credit is earned at a rate of 75 per cent on the first $100 contributed, 50 per cent on the next $450 contributed and 33⅓ per cent on the next $600 contributed. The maximum credit is $500 and is available when the taxpayer has contributed $1,150.

This measure constitutes a tax expenditure because political contributions are not incurred to earn income.

Canadian film or video production tax credit

The Canadian film or video production tax credit was introduced in the 1995 budget for certified Canadian film productions produced by qualified corporations. It provides a refundable investment tax credit of 25 per cent of the cost of eligible salaries and wages expended after 1994, except where the financing of the film is eligible for transitional relief from the termination of the CCA film incentive. Eligible salaries and wages are limited to 48 per cent of the cost of production, so that the credit provides assistance of up to 12 per cent of the cost of the production. Canadian film or video productions are certified by the Minister of Canadian Heritage.

This tax credit was intended to retarget government assistance available to Canadian film productions in order to maximize the benefit to such productions. It replaced a tax shelter of accelerated capital cost allowance deductions used principally by higher-income individuals with a refundable tax credit for eligible films produced by qualified taxable Canadian corporations.

Exemptions and Deductions

The following exemptions and deductions are considered tax expenditures because they deviate from the benchmark tax system.

Partial inclusion of capital gains

Three-quarters of net realized capital gains are included in income. The amount of the tax expenditure is the additional tax that would have been collected had the remaining one-quarter of the capital gains been included in income. However, this amount is likely an overestimate of the true amount of this tax expenditure. To the extent that the capital gains are from shares that have increased in value due to retained earnings, and which have already been taxed at the corporate level, the partial inclusion of the capital gains provides some relief from double taxation and, therefore, should be part of the benchmark tax system.

The 1997 budget proposed to reduce the inclusion rate on capital gains arising from certain donations to charities (other than private charitable foundations) from 75 per cent to 37½ per cent. Donations that would be eligible would be those of securities that are listed publicly on a recognized stock exchange in Canada, where the donation is made between February 18, 1997 and the end of the year 2001.

Royalties and mining taxes

Non-deductibility of Crown royalties and mining taxes

The current tax system does not permit a deduction for Crown royalties or mining taxes. The deduction has been denied since May 6, 1974. From that time to the end of 1975, oil and gas and mining companies were eligible for a resource tax abatement which provided a lower rate of tax on oil and gas and mining income. A resource allowance (discussed below) was introduced in the June 1975 budget and replaced the resource tax abatement after 1975.

A negative tax expenditure is calculated for the non-deductibility of Crown royalties and mining taxes. A negative tax expenditure implies that the government collects more income taxes than would have otherwise occurred in the benchmark system. The issue arises as to whether the benchmark tax system would include a deduction for all Crown royalties and mining taxes. Two generic types of non-deductible Crown charges are levied on the extraction of natural resources. One type is a simple royalty system where the Crown charge is based only on gross revenues. There are also more complex systems of Crown charges that are based on net resource profits – i.e. resource profits after the deduction of numerous costs, including capital, operating costs and sometimes a return on capital employed.

In the case of Crown charges based on gross revenues, the benchmark system would include a deduction for these royalties since they are analogous to costs of production. However, the benchmark tax system would not include a deduction for the latter type of profit-related Crown royalties and mining taxes because they are structured more like income taxes. Provincial income taxes are not considered to be a deductible expense in the benchmark system. Provincial payroll and capital taxes, on the other hand, are deductible and they are not treated as tax expenditures.

The calculations shown here represent the federal corporate income tax revenues generated by the current rules which deny the deductibility of all Crown royalties and mining taxes. No attempt has been made to divide the disallowed royalties into the two categories described above. This is, in part, due to the fact that many royalty systems include characteristics of both a gross and net calculation. Thus, the calculation represents an overestimate of the actual negative tax expenditure.

Resource allowance

Since 1976, the income tax system has provided a resource allowance deduction equal to 25 per cent of a taxpayer's annual resource profits, computed after operating costs and capital cost allowances, but before the deduction of exploration expenses, development expenses, earned depletion and interest expenses. The resource allowance is provided in lieu of the deductibility of Crown royalties, mining taxes and other charges related to oil and gas or mining production. The measure allows the provinces room to impose royalties or mining taxes on the production of natural resources while maintaining the federal income tax base. For analytical purposes, the value of the tax expenditure for the royalties and mining taxes is broken down into two components:

- the federal tax revenue earned by disallowing royalty deductibility (a negative tax expenditure, described above); and
- the federal tax revenue forgone resulting from the resource allowance deduction (a positive tax expenditure).

An approximation of the overall impact of the resource allowance measure (compared to the benchmark tax system) can be obtained by netting the two above effects.

Earned depletion

Earned depletion is an additional deduction from taxable income of certain exploration and development expenditures and other resource investments. Prior to 1990, taxpayers were entitled to earn an extra deduction of up to 33⅓ per cent of most exploration and development expenses or the costs of assets related to new mines or major expansions. The deductions for earned depletion are generally limited to 25 per cent of the taxpayer's annual resource profits although mining exploration depletion can be deducted against non-resource income. As in the case of a Canadian exploration expense or a Canadian development expense, earned depletion could be pooled (i.e. placed in a special account, and any remaining balance could be carried forward indefinitely for use in later years).

Additions to the depletion pools for earned depletion and mining exploration depletion were eliminated as of January 1, 1990. Deductions can still be made on the basis of existing depletion pools.

Under the benchmark tax system, a deduction for earned depletion would not be available.

Deductibility of charitable donations

Donations made by corporations to registered charities are deductible in computing taxable income within certain limits. Unused deductions may be carried forward for up to five years.

For years prior to 1996, this deduction was limited to 20 per cent of net income. The 1996 budget announced that the deduction limit would be raised to 50 per cent of net income plus 50 per cent of taxable capital gains resulting from the donation of property. The 1997 budget announced a further increase in the limit to 75 per cent of net income plus 25 per cent of the amount of taxable capital gains arising from the donation of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Deductibility of gifts to the Crown

Gifts made by corporations to Canada or a province are deductible in computing taxable income within certain limits. Unused deductions may be carried forward for up to five years.

Prior to 1997 the amount deductible was only limited to the amount of income in a particular year. The 1997 budget proposed to restrict the deductible amount to 75 per cent of net income plus 25 per cent of the amount of taxable capital gains arising from the donation of appreciated capital property, and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property. The limit would not apply to gifts of ecologically sensitive land and certain gifts of cultural property.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Interest on small business financing loans

Small businesses in financial difficulty are able to treat interest paid on small business financing (SBF) loans entered into between February 25, 1992 and the end of 1994 as a non-deductible payment and SBF lenders are permitted to treat the interest received as a dividend – resulting in such interest being non-taxable to corporate lenders and individual lenders being eligible for a dividend tax credit. This tax treatment permitted lenders to reduce the interest charges to such small businesses while maintaining their after-tax rates of return.

Non-deductibility of advertising expenses in foreign media

Expenses for advertising in non-Canadian newspapers or periodicals or on non-Canadian broadcast media cannot generally be deducted for income tax purposes if they are directed primarily to a market in Canada. Deducting the cost of advertising in foreign periodicals or on television stations is not restricted if the advertising is to promote sales in foreign markets.

This treatment results in a negative tax expenditure since the deduction of an expense incurred to earn income is denied. Under the benchmark tax system, advertising expenses in foreign media incurred to gain or produce income from a business or property would be deductible whether targeted at foreign or domestic markets.

No data are available.

Non-taxation of provincial assistance for venture investments in small business

Government assistance received by a corporation is normally either included in the corporation's income or reduces the cost basis of the assets to which the assistance relates for CCA purposes. There are a number of exceptions to this rule, including provincial assistance provided for venture capital investment under specified provincial programs. Under the benchmark tax system, this type of assistance would be included in the corporation's income or would reduce the cost basis of the related assets.

No data are available.

Deferrals

The tax expenditures in this section provide for a deferral of income taxes from the current to a later taxation year. They have been valued on a cash-flow basis (i.e. the forgone tax revenue associated with the additional net deferral in the year). The alternative way of valuing deferrals would be to calculate the value of the interest-free loan that is provided to the taxpayer when taxes are deferred to a later year.

Accelerated write-off of capital assets and resource-related expenditures

Under the benchmark tax system, corporations would be permitted an annual deduction for their use of capital assets based on their anticipated economic life. Using the cash-flow approach, the tax expenditure in any particular year would be calculated as the forgone tax revenue resulting from the difference between the deduction taken for tax purposes, usually CCA, and the true economic depreciation based upon the asset's useful economic life. These annual calculations of the impact on cash flow can provide some indication of the tax expenditures resulting from the accelerated deductions for capital assets but they could also be very misleading.

Tax expenditure amounts are not provided because:

- differences between the deductions for tax purposes and economic depreciation may not accurately reflect the tax expenditure; and
- adequate data are not available to calculate with any degree of accuracy this tax expenditure.

There are instances when differences between the deductions for tax purposes and economic depreciation would not accurately reflect the tax expenditure. First, it should be noted that the accelerated deductions for tax purposes lead only to a deferral, not a permanent reduction, of tax payable. If CCA rates are higher than actual depreciation rates, then during the initial years, the CCA claim would exceed economic depreciation. However, in later taxation years, the reverse would occur (i.e. actual depreciation would exceed the amount allowed for tax purposes). These differences between CCA and actual depreciation would lead to a positive tax expenditure in the early years of asset ownership since higher CCA rates in the initial years are a tax incentive. However, in later years, the CCA claim would be less than actual depreciation resulting in a negative tax expenditure, thus offsetting the previous tax expenditure to some extent. For the corporate sector in total, the aggregate tax expenditure in any particular year could be positive or negative depending upon the level of investment in the current and previous years. As a result, the tax expenditure depends critically on the growth rate of investments. If the growth rate were zero, then, in the long run, one would expect no tax expenditure amount since the positive tax expenditures resulting from more recent asset acquisitions would be offset by the negative tax expenditures resulting from older assets – that is, in total, the annual tax depreciation claimed would be equal to the economic depreciation.

In addition, because CCA is a discretionary deduction, the cash-flow method could result in a tax expenditure being reported even if there is no acceleration of CCA rates (i.e. the CCA rates correspond with economic depreciation rates). A company has discretion to claim less than the maximum amount in a particular year. As a result, in that year, the cash-flow method would result in a negative tax expenditure. Because the company would now have a larger undepreciated balance for tax purposes, future CCA write-offs would be larger than the corresponding economic depreciation, thereby resulting in a positive tax expenditure in future years.

Finally, differences between CCA and economic depreciation may also result from the treatment of dispositions. For tax purposes, assets are grouped in pools with gains or losses on disposition adjusting the undepreciated balance while gains and losses for economic depreciation purposes are recognized on an asset-by-asset basis. Also, the asset cost for tax purposes may differ from the cost for economic depreciation purposes in that, for economic depreciation purposes, interest costs are often capitalized while, for tax purposes, such costs are generally expensed in the year incurred.

Because economic depreciation is difficult to determine, the deductions for capital assets reported by companies in their financial statements are often used as a substitute. However, financial statement depreciation may differ from economic depreciation. Furthermore, not all companies classify the capital asset deductions as depreciation or some other readily identifiable expense. For example, in the leasing industry, a lease may be classified as an operating lease for tax purposes with capital cost allowance being claimed, while for accounting purposes, it may be classified as a capital lease, in which case the corresponding accounting deduction may not be specifically identifiable. Since

the costs written off for financial statement purposes for this sector cannot be precisely determined, it is not possible to estimate the related tax expenditure. More generally, adequate data are not available to calculate with any degree of accuracy this tax expenditure.

Although it may not be possible to estimate with any degree of accuracy the expenditure using the cash-flow approach, some indication of the magnitude of the tax expenditure relating to a particular accelerated write-off provision can be calculated by comparing the estimated discounted present value of the tax benefits resulting from acquisitions in a particular year under each of the two depreciation methods. For example, if the CCA rate is higher than the actual depreciation rate, the discounted present value of the benefit of being able to claim CCA would exceed the discounted present value of the benefit of the financial statement depreciation, thereby resulting in a measure of the positive tax expenditure or tax incentive that has been provided.

The number of asset classes with accelerated depreciation rates was reduced significantly when changes were introduced in 1988. As a result, many CCA rates now approximate the rate of economic or financial statement depreciation and the associated tax expenditure related to accelerated depreciation provisions has been reduced. However, a few instances remain where the CCA rates are clearly accelerated – that is, the tax system allows a larger deduction from income for the first few years after the property is acquired than is applied for financial statement purposes. Some of the more significant of these accelerated CCA provisions are described below along with illustrations of the net present value of the benefit of some of the remaining accelerated CCA provisions.

Vessels (class 7)

Vessels are generally included in class 7 and are subject to a maximum CCA rate of 15 per cent on a declining-balance basis. Accelerated CCA on a straight-line basis at a maximum rate of 33⅓ per cent of the capital cost of the property is available in respect of a vessel, including furniture, fittings, radio communication equipment and other equipment if it was (a) constructed in Canada, (b) registered in Canada, and (c) not used for any purpose whatever before acquisition by the owner. These assets are depreciated over a four-year period, with 16⅔ per cent written off in the first and fourth years, and 33⅓ per cent written off in the second and third years.

Railway assets (classes 35, 1 and 3)

Railway cars are generally included in class 35 and depreciated at a rate of 7 per cent on a declining-balance basis. However, some railway cars are eligible for additional allowances. Railway cars acquired by common carriers are eligible for an additional allowance of 3 per cent. Railway cars for rent or lease are generally eligible for an additional allowance of 6 per cent.

Other railway property such as track, grading, control or signalling equipment, is generally included in class 1 and subject to a 4-per-cent declining-balance rate. Certain railway property included in class 1 is eligible for an additional allowance of 6 per cent.

Railway trestles are generally included in class 3 and subject to a 5-per-cent declining-balance rate. Certain trestles are eligible for an additional allowance of 5 per cent.

These additional allowances generally raise the CCA rates on certain railway cars, track and other railway equipment acquired to 10 per cent.

Energy-efficient equipment (classes 34 and 43.1)

Prior to the changes announced in the 1994 budget, straight-line depreciation of 25 per cent, 50 per cent and 25 per cent was applicable to certain equipment used for the generation of electricity or the production or distribution of heat. Qualifying equipment includes equipment designed to: produce heat derived primarily from the consumption of wood wastes or municipal wastes; produce electrical energy by using wind energy; or recover heat that is a by-product of an industrial process. Also included as qualifying equipment were: hydro-electric installations not exceeding 15 megawatts; certain types of co-generation equipment; and certain types of active solar heating equipment.

The changes announced in the 1994 budget effectively terminated additions to class 34 after February 21, 1994, and redefined eligibility criteria. Many of the assets that had been eligible for class 34 became eligible for a reduced depreciation rate of 30 per cent on a declining-balance basis under class 43.1.

Class 43.1 was introduced following the termination of class 34. Eligibility for class 43.1 is described in draft regulations to the *Income Tax Act*. In general, the following types of equipment may qualify for inclusion in class 43.1: co-generation and specified waste-fueled electrical generation systems; active solar systems; small-scale hydroelectric installations; heat recovery systems; wind energy conversion systems; photovoltaic electrical generation systems; geothermal electrical generation systems; and specified waste-fueled heat production equipment. Active solar systems, heat recovery systems and waste-fueled heat production equipment must be used directly in connection with an industrial process to qualify as class 43.1 equipment.

Class 43.1 is also subject to the “specified energy property” rules which may reduce the amounts that can be deducted to less than 30 per cent of the unclaimed capital cost.

Water and air pollution control property (classes 24 and 27)

Assets which are acquired primarily for the purposes of abating water or air pollution at a site are included in class 24 or class 27, respectively. These assets are eligible for three-year straight-line CCA of 25 per cent, 50 per cent and 25 per cent. The water and air pollution control equipment must be new property that is used in operations that were started before 1974 and have been continuously carried on since that time. The 1994 budget announced that additions to these classes will be terminated after 1998.

Mining

Certain mining buildings, machinery and equipment acquired for use at a new mine or a major expansion of an existing mine may qualify for an accelerated CCA rate of up to 100 per cent. A 25-per-cent increase in a mine's capacity is generally considered to be a major expansion.

These mining assets were previously included in class 28 and depreciated at a rate of 30 per cent. Acquisitions after 1987 are included in class 41, and depreciated at a rate of 25 per cent. In addition to the 25-per-cent allowance provided in class 41, a taxpayer owning such property and operating the mine may claim an additional allowance equal to the lesser of (1) the remaining undepreciated capital cost of property of the class, or (2) the income for the year from the new or expanded mine.

The 1996 budget announced income tax changes for oil sands projects. The objective of the changes was to provide a more equitable tax treatment for the two different oil sands extraction methods (mining and *in situ*). Mining methods involve the removal of overburden and the transportation of bituminous sands to a central processing facility where the oil (bitumen) is separated from the sand using hot water. With *in situ* operations, the oil is recovered from an underground reservoir by the application of heat or other techniques which make the oil more mobile and capable of flowing from a well or wells.

The 1996 budget extended the accelerated CCA rules to the eligible depreciable capital costs for *in situ* projects. The tax treatment that previously had been available only for new mines (both mineral and oil sands) and major mine expansions was also extended to other capital investments, including large incremental capital costs that might not otherwise qualify as a major expansion (for example, efficiency improvements and environmental protection purposes). Specifically, all tangible capital expenditures incurred for all types of mines, including oil sands projects, would qualify for accelerated CCA to the extent that, in a year, these capital costs exceeded 5 per cent of gross revenue from that mine or oil sands project in that year.

Exploration costs

Expenditures incurred in determining the existence, location, extent or quality of mineral resources, and oil or gas, or incurred to develop mineral resources prior to commercial production in Canada are classified as a Canadian exploration expense (CEE) and deducted for tax purposes at a rate of 100 per cent.

Generally accepted accounting principles allow companies to depreciate exploration expenditures on either a "full cost" or a "successful efforts" basis. The full cost method requires that all exploration costs, whether they result in new production or not, be capitalized and amortized as the reserves are depleted. The successful efforts method requires that only those costs which result in the discovery of reserves and which have a benefit in terms of future revenues are capitalized; other costs are expensed as incurred. Most Canadian-controlled companies follow the full cost method, while foreign-controlled companies in Canada usually follow the successful efforts method.

The 100-per-cent write-off of CEE for tax purposes is more rapid than the amounts used for financial statement purposes, especially for successful exploration. The fast write-off for CEE provides a deferral of tax.

Under the benchmark tax system, corporations would be permitted an immediate deduction only for unsuccessful exploration expenditures. However, those costs associated with successful exploratory activities (i.e. those costs that result in producing assets for both the mining and oil and gas sectors) would be permitted a deduction based on an amortization over the life of the asset.

Under certain conditions, corporations entering into flow-through share agreements are entitled to reclassify limited amounts of a Canadian development expense (normally a 30-per-cent deduction on a declining-balance basis) into a Canadian exploration expense. The tax expenditure associated with this provision appears as a personal tax expenditure item since these deductions are taken by the purchasers of the flow-through shares which are generally individuals.

Capital equipment used for SR&ED

Eligible capital expenditures for the provision of premises, facilities or equipment used for SR&ED in Canada may be fully deducted in the year they are incurred. In the absence of this provision, these amounts would have been depreciable over several years. Under the benchmark tax system, expenditures that are capital in nature and designed to produce income in the future are depreciated over a period approximating that during which the income is expected to arise.

Illustration

Assuming a taxable corporation makes a $100,000 investment in an eligible asset, the net present value of the income tax reduction resulting from accelerated CCA is presented in the following table. This illustration is based upon a federal corporate income tax rate of 29.12 per cent and uses a discount rate of 8 per cent. The actual net present value of the reduced federal tax resulting from accelerated CCA will vary depending upon the tax status of the corporation, its effective tax rate, and the amount of CCA actually claimed in future years. The following table presents the maximum value of the incentive assuming that firms can fully benefit from the accelerated CCA. The one exception is for the analysis of mining assets (see table footnote).

	CCA Class	Accelerated rate	Baseline tax depreciation rate	Net present value of reduced federal tax resulting from accelerated CCA
Vessels	7	33⅓% straight-line	15% declining balance	$5,800
Railway cars	35	10% declining balance	7% declining balance	$2,500
Electrical generating equipment using wind, solar and geothermal energy	43.1	30% declining balance	4% declining balance	$12,800
Energy-efficient equipment used in manufacturing and processing (pre-1994 budget)	34	50% straight-line	30% declining balance	$2,900
Water and air pollution control property	24 and 27	50% straight-line	30% declining balance	$2,900
Mining assets				
Oil sands and *in situ* oil	28 and 41	100% (subject to income restriction)	25% declining balance	$500 to $4,000[1]
Conventional mines	28 and 41	100% (subject to income restriction)	25% declining balance	$500 to $1,300[2]
Scientific research and experimental development equipment	Full write-off in year	Full write-off in year	30% declining balance	$4,800
Exploration costs	Full write-off in year	Full write-off in year	30% declining balance	$4,800

[1] Accelerated CCA can only be claimed against income earned by the related project, not against total corporate income. The income of the project, in turn, depends *inter alia* on prices for oil/minerals. Therefore, the net present value of the federal tax reduction resulting from claiming accelerated CCA varies depending upon the amount of project income against which CCA may be claimed. These estimates are based on the operating results of a range of existing and proposed oil sands mining and *in situ* oil sands projects as obtained from industry sources. The calculations result in a range of $500 to $4,000 per $100,000 investment; however, most oil sands projects would generally fall between $700 and $2,500.

[2] For conventional mines, the analysis was based on hypothetical mine models developed by Natural Resources Canada. These models include a range of low and high profitability metal mines.

Allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income.

Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to a capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted against uncertain taxable capital gains in the future.

Holdback on progress payments to contractors

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g., 10 per cent to 15 per cent) is often held back until the entire project is completed satisfactorily. The amount held back need not be brought into the income of the contractor until the project to which it applies is certified as complete, rather than when earned as would be required in the benchmark tax structure. Where a contractor, in turn, withholds an amount from a subcontractor, costs equal to the amount of the holdback are not considered to have been incurred by the contractor and are not deductible until paid. The net impact of these two measures on a given contractor's tax liability depends on the ratio of holdbacks payable to holdbacks receivable. If holdbacks receivable are greater than holdbacks payable, there is a deferral of tax. If holdbacks payable exceed holdbacks receivable, there is a prepayment of taxes.

Increases in net holdbacks receivable or decreases in net holdbacks payable result in a positive estimate of the amount of the tax expenditure. Increases in net holdbacks payable or decreases in net holdbacks receivable result in a negative estimate.

Available for use

Taxpayers may claim CCA and ITCs on eligible property at the earlier of the time it is put in use or in the second taxation year following the year of acquisition. Property that becomes eligible for CCA and ITCs by virtue of the two-year deferral rule could result in a significant mismatch of revenues and expenses which give rise to a tax deferral. This is a tax expenditure because taxpayers are allowed to claim deductions and tax credits on property before it is put in use.

No data are available as assets are pooled into classes and are not accounted for separately. Furthermore, assets are not identified as being "available for use" or "not available for use".

Capital gains taxation on realization basis

Capital gains are taxed upon the disposition of property and not on an accrual basis. This treatment results in a tax deferral. Furthermore, certain roll-over mechanisms such as share-for-share exchange provisions extend the period of tax deferral. Under the benchmark tax system, capital gains would be fully included in income as they accrue.

However, since 1994, financial institutions and investment dealers have been required to report gains and losses on certain securities on an accrual basis (i.e. mark to market).

No data are available.

Expensing of advertising costs

Advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future. Under the benchmark tax system, the expenses would be amortized over the benefit period.

The estimates provided are based upon the assumption that 25 per cent of advertising costs incurred in a particular year provide a benefit in the following two years. Since tax expenditures are estimated on a cash-flow basis, an increase in annual advertising costs would result in a positive estimate of the tax expenditure. Decreases in annual advertising costs would result in a negative tax expenditure.

Deductibility of contributions to mine reclamation and environmental trusts

Certain environmentally sensitive activities can disturb the natural environment in the area where the activity takes place, and measures may need to be taken to repair the environmental damage after operations have terminated. In these situations, governments may require companies to set aside funds in advance in trust funds to ensure that adequate amounts are available to conduct restoration activities at the end of operations.

The 1994 budget permitted a deduction of required contributions to mine reclamation trusts in the year in which they are made rather than permitting a deduction only when the mine reclamation costs are actually incurred. Income earned in such trusts is subject to tax each year. When actual reclamation costs are incurred, any withdrawal of funds from the trust will be included in income subject to tax and the actual reclamation costs will be deductible. The 1997 budget extended this treatment to similar funds established for waste disposal sites and quarries for the extraction of aggregate and other similar substances.

The overall effect is to advance the timing of the deduction in respect of reclamation expenses. The value of the tax expenditure is the amount of tax relief that is effectively provided by allowing payments to be deducted from income when contributions are made to the trust. This tax expenditure could be positive or negative depending upon the amount of contributions to and withdrawals from these trusts in a particular year.

Deductibility of countervailing and anti-dumping duties

In accordance with the rules established under the World Trade Organization, countervailing and anti-dumping duties may be imposed by countries to offset the injurious effects of imports which are subsidized or dumped. These actions may result in Canadian taxpayers paying such amounts in order to export their products. The 1998 budget proposes that cash outlays for duties be deductible in computing income subject to tax in the year they are paid even though these amounts may be refunded, in whole or in part, in a subsequent year. Any refunds or additional amounts subsequently received, such as interest, would have to be included in income in the year of receipt.

The value of the tax expenditure is the amount of tax relief provided by allowing these contingent costs to be deducted from income when paid rather than when the exact amount, if any, of the duty is determined. This tax expenditure could be positive or negative depending upon the amount of countervailing duties paid and recovered by firms in a particular year.

No forecasts have been made of the future tax expenditure amounts since it is not possible to determine the cost of future trade actions affecting Canadian taxpayers.

Deductibility of earthquake reserves

In 1997, the Office of the Superintendent of Financial Institutions (OSFI) introduced new guidelines that require federally regulated insurance companies to meet target levels of preparedness to ensure they have sufficient financial capacity to pay insured earthquake losses when they occur. The draft appendix to the guidelines proposes an earthquake reserve to be composed of two parts: the first element, the 'earthquake premium reserve', is based on a percentage of net earthquake premiums written; and the second element, the 'earthquake reserve complement', takes into account the earthquake exposure reinsured with another insurance company and a proportion of the capital and surplus of the company. The 1998 budget proposes that the 'earthquake premium reserve' will be deductible for income tax purposes. Under the benchmark system, such reserves would not be deductible.

Cash basis accounting

Farming and fishing corporations may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues.

No data are available.

Flexibility in inventory accounting

Farm corporations using the cash basis method of accounting are allowed to depart from it with regard to their inventory. A discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farm corporations to avoid creating losses which, if carried forward, would be subject to the time limitation. Thus the tax expenditure provides tax relief to the extent that the losses would otherwise have been subject to the time limitations.

No data are available.

Deferral of income from grain sold through cash purchase tickets

Farmers may make deliveries of grain before the year end and be paid with a ticket that may be cashed only in the following year. The payment for deliveries of grain is included in income only when the ticket is cashed, thereby providing a deferral of taxes. Under the benchmark tax system, income would be taxed on an accrual basis.

The estimates are based on data provided by the Canadian Wheat Board. Since tax expenditures are estimated on a cash-flow basis, an increase in the balance of uncashed grain tickets represents additional income that is being deferred and results in a positive estimate of the tax expenditure. A decrease in the balance of uncashed grain tickets indicates that less income is being deferred and results in a negative tax expenditure.

Deferral of income from destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxed on an accrual basis.

Deferral of tax from use of billed-basis accounting by professionals

Under accrual accounting, costs must be matched with their associated revenues. However, in computing their income for tax purposes, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

International

Non-taxation of life insurance companies' world income

All Canadian corporations except Canadian multinational life insurers are taxed on their worldwide income. Canadian multinational life insurers are taxed only on their profits from carrying on a life insurance business in Canada using special rules in the income tax regulations.

Prior to 1993, the cost of this tax expenditure was estimated from tax returns and information available from the Office of the Superintendent of Financial Institutions. However, information required to estimate this tax expenditure is not available after 1992.

Exemptions from non-resident withholding tax

Canada, like other countries, imposes a withholding tax on various types of income paid to non-residents. The basis for this tax rests on the internationally accepted principle that a country has the right to tax income that arises or has its source in that country. The types of income subject to non-resident withholding tax include: certain interest, dividends, rents, royalties and similar payments; management fees; estate and trust income, alimony and support payments; as well as certain pension, annuity and other payments.

Over time, as the benefits of freer trade in capital, goods and services have been increasingly recognized, countries including Canada have adjusted their tariff and tax structures to remove impediments to international transactions. Part of this adjustment has been the reduction of non-resident withholding tax on certain payments.

Canada's statutory non-resident withholding tax rate is 25 per cent. However, the rate is lowered and exemptions provided for certain payments through an extensive network of bilateral tax treaties. These rate reductions, which apply on a reciprocal basis, differ depending on the type of income and the tax treaty country.

The *Income Tax Act* also provides for a number of unilateral exemptions from withholding tax including: exemptions for interest payments on government debt; interest payments to arm's-length persons on long-term corporate debt; interest payments to arm's-length persons on foreign currency deposits with branches of Schedule I banks; and royalty payments for the use of copyright.

Lower withholding taxes can reduce the cost to Canadian business of accessing capital and other business inputs from abroad. For example, a lower Canadian withholding tax on interest payments to non-residents can reduce the cost of accessing foreign capital in cases where foreign creditors raise the interest rate charged to cover payment for withholding tax. Similarly, a reduced withholding tax on royalty payments can reduce the cost of accessing foreign technology and other property and services, and thereby enhance the competitiveness of Canadian businesses requiring these inputs.

The estimates of the tax expenditures associated with withholding tax exemptions for certain royalties, interest, dividends and management fees paid to non-residents were derived from a detailed analysis of payments to non-residents and withholding tax collections on those payments for 1992, 1993 and 1994, and projections of payments to non-residents over the post-1994 period. The cost estimates were derived by applying treaty withholding tax rates (in the case of payments to a country with which Canada had a tax treaty in the year considered) or the statutory 25-per-cent withholding tax rate (in the case of payments to non-treaty countries), that would otherwise apply in the absence of an exemption, to observed and projected payments data under the benchmark assumption used throughout this publication of no behavioural response to the hypothetical removal of existing withholding tax exemptions.

This benchmark assumption of no behavioural response is particularly difficult to sustain for this type of tax. Foreign providers of capital, technology and other property and services, in most cases, are unwilling to bear the withholding tax given that they do not pay such a tax when supplying other markets. If a withholding tax was to be imposed, foreign providers would either require that the tax be shifted back to the Canadian borrower or user of property or services in the form of higher charges (which in many cases could not be absorbed), or they would bypass Canada in favour of other foreign markets where such a tax does not exist, again implying increased financing and other business costs to Canadians. Indeed, these same competitiveness considerations have led to the introduction of a number of withholding tax exemptions both in Canada and in other countries.

Thus, these particular tax expenditure estimates cannot be interpreted as additional revenues that could be collected from non-residents if the withholding tax exemptions were removed, since the removal of the exemptions would generally involve the elimination of the tax base.

Exemption from Canadian income tax of income earned by non-residents from the operation of a ship or aircraft in international traffic

Non-resident persons operating a ship in international traffic are exempted from Canadian income tax as is done in other countries. Similarly, non-resident persons operating an airline in international traffic are exempted from Canadian income tax. In both cases, the exemption applies only if the non-resident's home country gives Canadian residents substantially similar tax relief. The amount of the tax expenditure is the tax that would otherwise be payable on profits related to the Canadian business of the non-resident persons, net of the tax collected on the non-Canadian income of the resident persons.

No data are available.

Other Tax Expenditures

Transfer of income tax room to provinces in respect of shared programs

In 1967, federal-provincial fiscal arrangements were altered. The federal government substituted a transfer of corporate income tax points for direct transfers to provinces under the cost-shared program for post-secondary education. The tax change involved an increase in the corporate income tax abatement rate from 9 to 10 percentage points, effectively reducing the federal corporate income tax rate at that time from 37 per cent to 36 per cent (the rate before the abatement was 46 per cent). This transfer of tax room has been included as a tax expenditure because it is a substitute for direct spending programs.

Interest credited to life insurance policies

Life insurance companies are taxed under the investment income tax (IIT) at a rate of 15 per cent on net investment earnings attributable to life insurance policies.

The IIT interacts with the taxation of policyholders. The *Income Tax Act* divides life insurance policies into two categories: savings-oriented policies and protection-oriented policies.

Savings-oriented policies are those where the amount of money invested in the policy is large relative to the death benefit. A holder of a savings-oriented policy is subject to annual accrual taxation in respect of the net investment earnings credited to the policy. Net investment earnings reported by these holders are subtracted from the IIT base in order to avoid double taxation of net investment earnings.

In contrast, a holder of a protection-oriented policy is not subject to annual accrual taxation. Net investment earnings are taxed when the policy is sold or surrendered, terminated (other than by death), or when paid out as policy dividends once the cumulative dividends exceed the total premiums paid under the policy. Net investment earnings that are taxable to holders of protection-oriented policies are also deductible from the IIT base.

Most of the cost of the tax expenditure relates to protection-oriented policies. This cost has three basic elements:

- differences between personal and IIT rates;
- timing differences (i.e. policies that are eventually taxed in the hands of policyholders); and
- permanent differences (i.e. policies that are held until the death of the insured).

Non-taxation of registered charities and other non-profit organizations

Registered charities and other non-profit organizations, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the charity or organization has taxable income, mainly investment income or profits from certain commercial activities.

No data are available.

Income tax exemption for provincial and municipal corporations

Provincial Crown corporations and municipal corporations are exempt from income tax. Under the benchmark tax structure, such corporations would be taxable to the extent that they had taxable income.

No data are available.

Non-taxation of certain federal Crown corporations

While federal Crown corporations are generally not subject to income tax, those Crown corporations that carry on significant commercial activities are taxable. It is possible, however, that some exempt corporations have income that would be taxable under the benchmark tax system.

No data are available.

Excise tax transportation rebate

The excise tax transportation rebate, introduced in 1991 and effective for the 1991 and 1992 calendar years, allowed transportation businesses to receive an excise tax rebate of 3 cents for each litre of eligible fuel on which federal fuel excise tax of 4 cents per litre was paid. In exchange, businesses that elected to receive this rebate were required to reduce their income tax losses by 10 dollars for every one dollar rebated. This provided the industry with an immediate cash-flow benefit at the cost of lower loss carry-forwards to offset income taxes in future years.

This rebate was applicable to purchases of diesel and aviation fuel subject to federal excise tax during the 1991 and 1992 calendar years.

A simpler option was available for trucking businesses that could elect to receive a rebate of 1½ cents per litre up to a maximum of $500 per taxpayer in lieu of the 3-cent-per-litre rebate.

Aviation fuel excise tax rebate

The aviation fuel excise tax rebate, which is effective for the calendar years 1997 to 2000 inclusive, provides excise tax rebates on the aviation fuel used by airline companies. Rebates are limited to $20 million per year per associated group of companies. In order to receive a rebate, a company must agree to reduce its income tax losses by 10 dollars for every one dollar of rebate.

Surtax on the profits of tobacco manufacturers

Tobacco manufacturers are subject to a special surtax on their profits. The surtax is levied at a rate of 40 per cent of the Part I tax on tobacco manufacturing profits. The surtax was originally announced as part of the National Action Plan to Combat Smuggling in February 1994. In November 1996, the government announced that the surtax would be extended for an additional three years to February 2000.

The surtax is considered a tax expenditure because it constitutes a departure from the benchmark system. Because the surtax results in more revenues than would otherwise be raised under the benchmark tax system, it is a negative tax expenditure.

Temporary tax on the capital of large deposit-taking institutions

The temporary surcharge is levied at a rate of 12 per cent of the financial institution capital tax imposed under Part VI of the *Income Tax Act* calculated before any credit for income taxes and as if there was a capital deduction of $400 million. The surcharge applies to financial institutions as defined under Part VI, but not to life insurance companies. The surcharge is not eligible to be offset by tax payable under Part I.

The surcharge was introduced in the 1995 budget for a period of 18 months; extended for one year in the 1996 budget; and extended for another year in the 1997 budget. The 1998 budget proposes to extend the surcharge for another year to October 31, 1999.

The surcharge is considered a tax expenditure because it constitutes a departure from the benchmark system. Because the surcharge results in more revenues than would otherwise be raised under the benchmark tax system, it represents a negative tax expenditure.

Memorandum Items

Refundable Part I tax on investment income of private corporations

This and the following item are parts of the tax system that provide some integration between the personal and corporate tax systems. Their values are calculated as additional corporate taxes that would be owing if corporations and individuals were treated as separate tax units.

A portion of the income taxes paid on investment income received by a private corporation (excluding deductible intercorporate dividends) is refunded to a CCPC when this income is paid out to shareholders as dividends.

Prior to June 30, 1995, a corporation's refundable tax equalled approximately 20 percentage points of the Part I tax paid on its investment income. To further ensure the integration of corporate and individual income taxes, an additional refundable tax of 6⅔ per cent is levied on the investment income received after

June 30, 1995 by a CCPC. This additional tax is refunded to a private corporation, along with refundable Part I tax, when the investment income is paid to shareholders as dividends. Corporations receive a refund from their refundable tax account at a rate of one dollar for every three dollars of taxable dividends paid.

Refundable capital gains for investment corporations and mutual fund corporations

Capital gains realized by an investment corporation and a mutual fund corporation are taxed at the corporation level and the tax is accumulated in the "refundable capital gains tax on hand" account. The corporation uses this account to claim a capital gains refund when it distributes capital gains dividends to its shareholders or through share redemptions by a mutual fund corporation. Since these dividends are capital gains distributions, they are taxed as capital gains in the hands of the shareholder and not as dividends.

This measure is considered a tax expenditure because it constitutes a departure from the benchmark system by allowing a public corporation (that qualifies as an investment corporation or a mutual fund corporation) to flow out its capital gains to shareholders. The result is that the distributed capital gains will be taxed at the same rate as if the corporation were a private corporation.

Loss carry-overs

The cyclical nature of business and investment income suggests that the impact of such income should be viewed over a longer period of time rather than on an annual basis. As a result, carry-overs of losses are treated as part of the benchmark tax system. The loss carry-over rules permit taxpayers to apply their losses against past or future income. The estimates provided indicate approximately how much tax revenue the government forgoes by allowing current year losses to be carried back (i.e. applied to reduce tax paid in previous years) and by allowing losses of previous years to be carried forward and applied to reduce tax otherwise payable for the current year. There are four types of losses that can be carried over, and specific provisions apply to each.

Non-capital losses

A non-capital loss is a company's loss from business operations. Non-capital losses may be carried back three years and forward seven years to reduce or offset the corporation's taxable income.

Estimates reflecting the impact of the carry-forward of prior years' losses include the revenue impact of allowing non-capital losses of previous years to be applied to reduce Part I tax and the refundable Part IV tax otherwise payable for the current year. Estimates reflecting the impact of allowing current year losses to be carried back (i.e. applied to reduce income tax paid in previous years) include the impact of allowing current year losses to be carried back to reduce both Part I tax and refundable Part IV tax.

Net capital losses

A net capital loss can arise from the disposition of capital property. This type of loss may be carried back three years and forward indefinitely but can only be applied against net taxable capital gains.

Estimates include the revenue impact of allowing net capital losses of previous years to be applied to reduce income tax otherwise payable for the current year and the impact of allowing current year net capital losses to be carried back (i.e. applied to reduce income tax paid in previous years).

Farm losses and restricted farm losses

A corporation can deduct, in the calculation of net income, a loss incurred from a farming or fishing business. The unused losses of this business may be carried back three years and forward 10 years.

When the corporation's major source of income is not farming, the amount of farming losses deductible in the year is restricted to a maximum of $8,750. The unused losses, defined as the excess of the net farm losses over the farm losses deductible in the year, are considered restricted farm losses. Restricted farm losses may also be carried back three years and forward 10 years but can only be applied against farm income.

Estimates consist primarily of the revenue impact of allowing farming losses of previous years to be applied to reduce income tax otherwise payable for the current year.

The revenue impact of applying restricted farm losses is minimal.

Deductible meals and entertainment expenses

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 50 per cent of the cost of food, beverages and entertainment (80 per cent before March 1, 1994) in order to reflect the personal consumption portion of these costs. To the extent that the business-related portion (i.e. the amount deductible under the benchmark system) exceeds the 50-per-cent deductible portion (80 per cent before March 1, 1994) there would be a negative tax expenditure since too large a portion of the costs is denied. Conversely, if the business-related portion is less than the tax deductible portion, there would be a positive tax expenditure. The estimates provided reflect the additional tax revenue that would be received if no deduction were allowed (i.e. that there is no business purpose to the expenditure).

Large corporations tax

The large corporations tax (LCT) was introduced on July 1, 1989 as a tax on the Canadian capital of large corporations. The rate of tax in 1993 and 1994 was 0.2 per cent. The 1995 budget increased the LCT rate to 0.225 per cent effective budget day 1995.

This tax ensures that all large corporations, and groups of related corporations, with more than $10 million of taxable capital employed in Canada, pay some federal tax. Companies can reduce their LCT liability to the extent of the Canadian portion of their corporate surtax. The rate of corporate surtax was increased from 3 per cent to 4 per cent in the 1995 budget.

Threshold

The $10 million capital deduction effectively exempts smaller corporations from the LCT as long as these corporations are not related to other corporations subject to the LCT – that is, the $10 million deduction must be shared among related corporations. This capital deduction is not considered to be a tax expenditure because it is generally available to all corporations.

Exempt corporations

Certain corporations such as non-resident investment corporations, deposit insurance corporations and corporations exempt from paying Part I income tax are exempt from paying the LCT. This exemption is a tax expenditure, but data are not available to estimate its value.

Patronage dividend deduction

In computing income for a taxation year, a taxpayer is allowed to deduct patronage dividend payments made to customers. Patronage dividends are payments made to customers in proportion to their volume of business. The taxpayer is required to withhold 15 per cent of all patronage dividends in excess of $100 paid to each customer who is resident in Canada.

The appropriate benchmark tax treatment of patronage dividends is uncertain. These dividends could be considered to be analogous to the payment of a volume discount or the return of excess payments. With this view of the benchmark system, this would not be a tax expenditure.

Alternatively, these payments could be perceived as the distribution to members (or shareholders) of earnings which would not be deductible under the benchmark system. The amount shown, reflecting this view of the benchmark system, is the revenue impact of allowing patronage dividends to be deductible from income.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of two-thirds of any logging tax paid to a province and 6⅔ per cent of income from logging operations in that province. This reduction in federal taxes can be argued to be a tax expenditure for the same reasons explained under the analysis of the resource allowance deduction.

Deductibility of provincial royalties (joint venture payments) for the Syncrude project (remission order)

Taxpaying participants in the Syncrude project are permitted to deduct both the resource allowance and "joint venture payments" made to the province of Alberta in lieu of a royalty in computing income subject to tax. This is accomplished through a remission order. Under the benchmark tax system, these joint venture payments, which are profit sensitive, would not be deductible. The estimate of the tax expenditure is calculated as the value provided by this extra deduction less the reduction in the resource allowance.

Deductibility of royalties paid to Indian bands

Royalties and lease rentals paid to Indian bands in respect of oil and gas and mining activities on Indian reservations are considered to be Crown charges paid to Her Majesty in Right of Canada or of a province in trust to the Indian band. Unlike non-deductible Crown charges, amounts paid to the benefit of an Indian band are generally deductible for federal income tax purposes. In addition to the deductible Crown charges, a resource allowance is earned on the resource profits net of the deductible Crown charges.

The amounts paid to the Government of Canada in the form of mining and oil and gas royalties/lease rentals paid to Indian bands are provided below:

Oil and gas and mining royalties/lease rentals paid to Indian bands

	1992-93	1993-94	1994-95	1995-96	1996-97
			($ millions)		
Oil and gas	50.0	59.0	76.0	58.0	92.0
Mining	0.8	0.6	0.7	0.5	1.0

Source: Department of Indian Affairs and Northern Development.

Non-resident-owned investment corporation refund

A non-resident-owned investment corporation must pay income tax at a rate of 25 per cent. However, except for capital gains realized on taxable Canadian property, this tax is refundable when the surplus is distributed as taxable dividends

to the shareholders and the applicable rate of withholding tax then applies. The refund is designed to relieve the dividends paid to non-residents from double taxation that would otherwise result. The corporation is essentially treated as a conduit for the flow-through of income. The amounts reported estimate the tax revenues that would be generated if the non-resident-owned investment corporation refund was not available.

Investment corporation deduction

Investment income is taxed at the corporation level and in the hands of the individual who receives it as dividend payments. In order to achieve a certain degree of integration between the personal and corporate tax systems, the current rules allow an investment corporation to deduct from its Part I tax otherwise payable 20 per cent of the amount by which its taxable income exceeds its taxed capital gains.

This measure constitutes a tax expenditure because it allows a public corporation that qualifies as an investment corporation to benefit from elements of the integration system which are usually available only to private corporations. The tax expenditure is estimated as the additional revenue that would have been collected by the government if investment income (except capital gains) had been taxed at the general income tax rate applicable to public corporations.

Deferral of capital gains income through various roll-over provisions

The taxation of capital gains is affected by provisions that permit taxpayers to defer realization for tax purposes through various roll-over provisions. Since the benchmark tax structure includes all accrued gains, this item is identified separately for information purposes. Examples include:

- the transfer of assets to a corporation or partnership in consideration for share capital or a partnership interest;
- amalgamations of taxable Canadian corporations;
- the winding-up of a subsidiary corporation into its parent corporation; and
- share-for-share exchanges.

The 1994 budget made changes that curtail the use of various roll-over provisions in certain reorganizations.

No data are available.

Deduction for intangible assets

Three-quarters of eligible capital expenditures on intangible assets are added to the cumulative eligible capital of a taxpayer. A deduction of up to 7 per cent of cumulative eligible capital at the end of the year is allowed. Examples of intangible assets include goodwill, customer lists and franchises.

The deduction for intangible assets could give rise to positive or negative tax expenditure estimates depending on the actual rate of depreciation of these assets relative to the amount that is permitted for tax purposes.

No data are available.

Tax exemption on income of foreign affiliates of Canadian corporations

The Canadian system for taxing the income of foreign affiliates of Canadian shareholders or the dividend income of the Canadian shareholders derived from foreign affiliates is based on the objectives of encouraging international competitiveness, protecting the tax base and eliminating double taxation.

Where the foreign affiliate earns active business income, Canada defers any recognition of that income until it is paid to the Canadian shareholders as a dividend on shares of the affiliate. In cases where the business income has been earned in a country with which Canada has a double taxation treaty, the dividend paid out of that income to Canadian corporate shareholders is not subject to additional Canadian tax. Where the business income is earned in non-treaty countries, the dividend is taxed in Canada but a tax deduction is provided to Canadian corporate shareholders based on the underlying foreign tax paid.

Where the foreign affiliate earns passive income and the affiliate is a controlled foreign affiliate of a person resident in Canada, the passive income is taxed in the Canadian shareholder's hands on an accrual basis. The Canadian shareholder can deduct taxes paid in the foreign jurisdiction in determining net additional Canadian tax liability. When the income earned in the foreign affiliate is actually paid to the shareholder in the form of a dividend, a deduction from income subject to tax is provided to the extent that the income was included in income subject to tax in a previous year.

Questions arise as to what should be the appropriate benchmark system to measure the value of the tax expenditure, if any, in this case. Basically, three different benchmarks could be contemplated:

- **Canada should tax only Canadian-source income.**
  This is the territorial approach. Under this approach, foreign subsidiaries of Canadian companies would face the same tax burden on foreign-sourced business income as locally owned enterprises in the foreign jurisdiction. This approach is consistent with the concept of capital-import neutrality. Capital-import neutrality results when the shareholders of subsidiaries do not face additional taxes in Canada with respect to the foreign business income earned by their subsidiaries. This is the effect of Canada's decision not to tax dividends arising from affiliates in countries with which Canada has entered into a double taxation agreement as a way to relieve double taxation. If this exempt dividend approach were to be considered as the benchmark, then no preference would be associated with the foreign dividend exemption.

- **Income earned by a foreign affiliate should be taxable in Canada when dividends are paid to the Canadian shareholder and double taxation alleviated with a foreign tax credit.**
  This is the approach used by a number of countries since it allows for additional taxes to be collected in the country of residence of the shareholder of a foreign affiliate at the time a dividend is paid to the shareholder by the affiliate out of foreign business income. These additional taxes would be levied when domestic tax payable exceeds the amount of foreign taxes paid both on the dividend itself and on the underlying foreign corporate profits out of which the dividend was paid. In Canada, dividends from foreign affiliates that do not qualify as exempt dividends are taxed on this basis. If this were to be considered the benchmark system, then the exempt dividend system would provide a preference, measured as the additional tax, net of the foreign tax credit, that would have been payable had the dividend been taxable in Canada.

- **Income earned by foreign affiliates should be taxable in Canada as it accrues to the Canadian shareholder (i.e. on a current basis).**
  This system is consistent with the concept of capital-export neutrality, which states that income of foreign affiliates should be subject to the same tax in the hands of its shareholders on a current basis regardless of whether the income is earned domestically or in a foreign affiliate. Certain passive income earned by controlled foreign affiliates is taxable on this basis in Canada. If this system was to be viewed as the benchmark, both the exempt dividend and the foreign tax credit approaches would be said to provide a preference measured as the deferral of incremental Canadian tax from the time the income is earned until the time the dividend is paid out.

Each of these three possible benchmarks has a policy justification. Data required to compute the amount of tax preference associated with any of the benchmarks are currently unavailable.

Chapter 6

Description of the Goods and Services Tax Provisions

Since the goods and services tax (GST) is levied at all points in the production and distribution chain, the value-added nature of the tax makes it equivalent to a retail sales tax levied on the sale of goods and services to the final consumer. Based on this equivalency, the GST base can be estimated from a Sales Tax Model constructed using data obtained from Statistics Canada's input-output tables and the National Income and Expenditure Accounts.

The data from the input-output tables are used to derive detailed expenditures by commodity for households, public sector bodies and exempt businesses. The personal expenditure categories of the input-output tables, along with the investment categories for residential construction and real estate commissions, are used to derive commodity expenditures for households. The commodity expenditures of public sector bodies are derived from certain personal expenditure categories, current government expenditure categories and appropriate investment categories contained in the input-output tables. (Public sector bodies include the federal government, provincial governments, municipalities, universities, school boards, public colleges, hospitals, charities and non-profit organizations.) The commodity expenditures of exempt businesses are derived from the input matrix of the input-output tables.

The commodity data described above are used to identify the impact of the GST provisions that either zero-rate or exempt certain goods and services. In some cases, modifications had to be made to the data derived from the input-output tables and the National Income and Expenditure Accounts to account for the structure of the GST. Since final input-output tables for a given year are available only four years after the fact, National Income and Expenditure Accounts data are used to project the impact of each GST provision to the relevant historical year. Expenditure data contained in the Department of Finance's Canadian Economic and Fiscal Model (CEFM) are used to project the impact of most of the GST provisions over the forecast period.

The Sales Tax Model is not the sole source of the estimated tax expenditures associated with the GST. In some cases, actual data from Revenue Canada were used for the tax expenditure estimates. In other cases, estimates were derived from entirely different sources. This chapter describes the various GST expenditure estimates and how they were derived.

Zero-Rated Goods and Services

Basic groceries

Basic groceries, which include the majority of foodstuffs for preparation and consumption at home, are zero-rated under the GST. However, the tax is charged on certain goods such as soft drinks, candies and confections, and alcoholic beverages.

The cost of the tax expenditure can be estimated using the Sales Tax Model by identifying commodities purchased by final consumers and public sector bodies which are currently not subject to tax. The majority of these purchases are contained in Statistics Canada's personal expenditure category "Food and Non-Alcoholic Beverages".

Prescription drugs

Drugs that are controlled substances for which a prescription is required are zero-rated. This provision also includes other drugs that have been prescribed by a recognized health care practitioner. The associated dispensing fee is also zero-rated. However, this provision excludes those items labelled or supplied for veterinary use.

The estimate is derived using the Sales Tax Model. However, an adjustment is made to reflect the fact that the input-output commodity "Pharmaceuticals" includes both prescription and non-prescription medicine. The ratio used to separate these two categories of medicine is based on information provided by Statistics Canada.

Medical devices

A wide range of medical devices is zero-rated under the GST. This includes canes; crutches; wheelchairs; medical and surgical prostheses; ileostomy and colostomy devices; artificial breathing apparatus; hearing and speaking aids; prescription eyeglasses and contact lenses; various diabetic supplies; and selected devices for the blind and for the hearing or speech impaired. In some instances, a device qualifies for tax-free status only if prescribed by a recognized health care practitioner.

The estimate is obtained using the Sales Tax Model. The zero-rated medical devices are found in the input-output commodities "Personal Medical Goods", "Medical and Dental Equipment and Supplies", and "Ophthalmic Goods". An adjustment is made to reflect the fact that the input-output commodities "Personal Medical Goods" and "Ophthalmic Goods" include expenditures made by final consumers which are not zero-rated under the medical devices provision. The ratio used to separate the zero-rated from the non-zero-rated expenditures is based on information provided by Statistics Canada.

Agricultural and fish products and purchases

Instead of taxing sales and providing input tax credits at early stages in the food production-distribution chain, certain agricultural and fish products are zero-rated all through the chain. A prescribed list of such supplies includes farm livestock, poultry, bees, grains and seeds for planting or feed, hops, barley, flax seed, straw, sugar cane or beets, etc. In addition, prescribed sales and purchases of major types of agricultural and fishing equipment are zero-rated.

The main effect of this provision is on the cash-flow position of taxpayers. For example, in the normal operation of the GST, farmers would pay the GST on taxable purchases and would claim a corresponding input tax credit at the end

of their tax period. However, in the case of prescribed zero-rated supplies, the farmer does not pay the GST and so does not have to wait to claim an input tax credit. Consequently, the cash-flow position of the farmer is improved. At the same time, however, the suppliers lose the benefit of holding the GST on these purchases until the end of their tax period. Since the aggregate tax liability of these taxpayers remains unchanged, the revenue implications of this measure are small.

Certain zero-rated purchases made by exporters

Certain supplies of goods and services delivered in Canada but subsequently exported are zero-rated. These include:

- the supply of goods to a recipient who intends to export them, provided they are not excisable goods (spirits, beer or tobacco) and the goods are not further processed or modified in Canada by the recipient;
- the supply of excisable goods to a recipient who, in turn, exports the goods in bond;
- supplies of natural gas made to a person who is exporting the gas by pipeline and not further processing or using the gas in Canada before its exportation other than as fuel or compressor gas to transport the gas; and
- goods sold to duty-free shops licensed as such under the *Customs Act.*

As with agricultural and fish products, this provision has only cash-flow implications. Again, the impact of this measure on tax revenues is small.

Non-taxable importations

Certain importations are tax free under the GST. These importations include:

- goods, other than books and periodicals, valued at not more than $20 and mailed to residents of Canada from other countries;
- duty-free personal importations such as goods valued at not more than $500 and imported by Canadians who have been outside the country for more than seven days (the limit was $300 prior to June 13, 1995); and
- goods imported by foreign diplomats.

No data are available.

Zero-rated financial services

Financial services provided to non-residents are generally zero-rated. However, there are certain exceptions (e.g., financial services that relate to debt arising from deposits in Canada, real property situated in Canada, goods purchased for use primarily in Canada, services performed primarily in Canada).

The zero-rating provisions enable Canadian financial institutions that generate significant amount of revenue through international activities to remain competitive in global markets.

Tax-Exempt Goods and Services

Residential and other personal-use real property

Certain real property transactions are exempt under the GST. These include sales of used residential property, sales of personal-use real property by an individual or a personal trust, and the sale of farmland to a family member who is acquiring the property for personal use.

Rentals of a residential complex (such as a house) or a residential unit (such as an apartment) for a period of at least a month are tax exempt. Short-term accommodation is also exempt where the charge for the accommodation is not more than $20 per day.

The estimate is derived using the Sales Tax Model based on the GST being applied to the input-output commodity “cash rent”, and incorporates the loss of the GST currently paid on business inputs purchased by the landlord. In addition, the estimate captures the GST being applied to certain consumer expenditures on the commodity “other rent” which represents exempt purchases of parking privileges associated with rental accommodation.

Health care services

Health care services are exempt under the GST. These services include the following categories:

- institutional health care services provided in a health care facility. These include accommodation, meals provided with accommodation, and rentals of medical equipment to patients or residents of the facility. However, it excludes meals served in a cafeteria, parking charges, or haircuts for which a separate fee is charged;
- services provided by certain health care practitioners whose profession is regulated by the governments of at least five provinces. This category includes nursing, dental, optometric, chiropractic, physiotherapy, occupational therapy, speech therapy chiropodic, podiatric, osteopathic, audiological and psychological services; and
- services covered by a provincial health insurance plan. Most of these services are already covered by the previous two provisions.

All exempt services that are covered by provincial health insurance plans are included in the benchmark because, under the Constitution, the GST does not apply to purchases made by provincial governments. Thus, the only cost from this provision involves health services purchased by final consumers. The estimates for this provision are derived from the Sales Tax Model.

Education services (tuition)

The GST provides an exemption for most educational services. The exemption includes tuition fees paid for courses provided primarily for elementary or secondary school students; courses leading to credits towards a diploma or

degree awarded by a recognized school authority, university or college; and certain other types of training for a trade or vocation. In addition, the exemption covers meals supplied to elementary or secondary students as well as most meal plans at a university or public college.

The estimate is derived from the revenues that would be collected if tuition fees were taxed and input tax credits were allowed for taxable purchases. The estimate takes into account the fact that universities and public colleges currently receive a rebate of 67 per cent of the tax that they pay on their purchases.

The estimate is derived from the Sales Tax Model based on the input-output commodity "Education Services" augmented by data contained in Statistics Canada's *Education Quarterly Review.*

Child care and personal services

Certain child and personal care services are exempt under the GST. The exemption covers the following:

- child care services provided for periods of less than 24 hours to children under 14 years of age; and
- certain personal care services including supplies of care and supervision to residents of an institution, as well as accommodation where it is provided for children or disabled or underprivileged persons.

The estimate is derived using the Sales Tax Model based on the input-output commodity "Personal Services, including Child Care" contained in the final demand category "Domestic and Child Care Services". The estimate reported here does not account for day care that might be paid by governments, or day care provided by a non-profit organization. However, the impact of these exclusions on the overall estimate is unclear since provincial expenditures would not be subject to tax and the remaining expenditures would be eligible for partial rebates if taxed.

Legal aid services

Legal services provided under a provincially authorized legal aid program are exempt under the GST. This includes payments by the client in respect of the legal aid services and payments by a legal aid society to a private lawyer for legal services.

There are two ways in which the tax is relieved:

- legal aid services delivered directly by the Crown or a Crown agency (as is the case in Nova Scotia, Newfoundland, Prince Edward Island, Quebec, Manitoba and Saskatchewan) are exempt; and
- legal aid services provided by private practitioners to a legal aid plan administrator are taxable. However, the person responsible for the legal aid plan is entitled to a rebate of 100 per cent of any tax paid on the supply.

Revenue Canada supplied the data related to the rebates provided to legal aid plans in the provinces of New Brunswick, Ontario, Alberta and British Columbia. To account for the other provinces where the service is explicitly exempt, provincial economic accounts data are used. Specifically, it is assumed that the value of legal aid services relative to the total expenditures contained in the provincial economic account category "Personal Business" in the tax-exempt provinces would be the same as in those provinces where a rebate is provided.

The projected expenditure estimate is based on the growth in consumption obtained from the CEFM.

Ferry, road and bridge tolls

International ferry services are treated as zero-rated like other international transportation services. Other ferry, road and bridge tolls are GST exempt.

The estimate is derived using the Sales Tax Model based on the expenditures of final consumers on the commodity "Highway and Bridge Maintenance".

Municipal transit

A municipal transit service is defined as a public passenger transportation service provided by a transit authority whose services are at least 90 per cent within a particular municipality and its surrounding areas. These municipal transit services are exempt under the GST.

The estimate is derived using the Sales Tax Model.

Exemption for small businesses

Businesses or individuals with annual revenues of $30,000 or less from taxable and zero-rated transactions may elect to be exempt under the GST. Such firms would not have to charge tax on their sales and would not be able to claim input tax credits on their business purchases.

The starting point in deriving the estimate is gross sales data for 1990 obtained from personal and corporate income tax information. From this data, one can estimate that the total sales from firms with annual sales of less than $30,000 accounts for approximately 0.5 per cent of all sales in the Canadian economy. This ratio can then be applied to the total gross GST collections to approximate the revenues that would arise from eliminating the small business threshold.

The projected expenditure estimate is based on the growth in nominal gross domestic product (GDP) obtained from the CEFM.

Quick method accounting

Small businesses registered under the GST are eligible to elect to account for GST using quick method accounting. Under the scheme, businesses do not have to keep track of the tax paid on most of their inputs. Instead, these firms remit a prescribed percentage of the GST that they collect on their sales.

The remaining GST collected is kept by the firm in lieu of the unaccounted input tax credits. The firm is eligible to claim an input tax credit for the tax paid on capital goods.

The estimate is derived from micro-statistical data for 1991 supplied by Statistics Canada. The take-up rate of this provision for eligible small businesses is about 22 per cent. The estimate for subsequent historical years is derived by projecting the 1991 estimate based on information regarding the growth in total input tax credits claimed which is obtained from Revenue Canada.

The projected expenditure estimate is based on the growth in nominal GDP obtained from the CEFM.

Water and basic garbage collection services

Water and basic garbage collection services are exempt under the GST. Charges levied for water and basic garbage collection services are captured in the commodity "Water, Waste Disposal and Other Utilities" contained in the input-output tables. The estimate is derived from the Sales Tax Model.

Domestic financial services

Financial services are defined to include services relating to financial intermediation, market intermediation and risk pooling. However, in many cases, the price of a financial service is implicit. For example, when banks provide lending and deposit-taking services, the banks' fees for these services are the spread between interest rates received from borrowers and the interest paid to depositors. The exact price associated with each financial transaction is difficult to determine and, therefore, it is difficult to apply the GST to the sale of the service. As a result, most financial services provided to residents of Canada are exempt under the GST.

Members of a "closely related group" (if there is at least 90-per-cent cross-ownership of voting shares between them) where one of the members is a "listed financial institution" could jointly elect to treat most supplies between them as tax-exempt financial services. The purpose of this election is to recognize that a closely related corporate group can be viewed as a single entity with respect to intragroup transactions.

No data are available.

Certain supplies made by non-profit organizations

Supplies that are GST exempt when made by non-profit organizations include recreational services provided primarily to children age 14 and under and individuals who are underprivileged or have a disability; supplies of food, beverages and lodging to relieve poverty or distress; and certain amateur performances.

No data are available.

Tax Rebates

Rebate for book purchases made by qualifying institutions

On October 23, 1996, the Minister of Finance announced that a 100-per-cent GST rebate would be provided on all book purchases made by public libraries, schools, universities, public colleges, municipalities, public hospitals and qualifying charities and non-profit organizations.

The initial expenditure estimate for 1997 is the estimated annual cost of implementing this provision. The projected expenditure estimate is based on appropriate expenditure data obtained from the CEFM.

Housing rebate

Purchasers of newly constructed residential dwellings and substantially renovated houses are eligible for a rebate of the GST paid if the purchaser is acquiring the dwelling as a primary place of residence. For houses priced at or below $350,000, the rebate is 36 per cent of the total GST paid to a maximum of $8,750. The rebate is phased out for houses priced between $350,000 and $450,000.

The estimate for historical years is obtained from Statistics Canada's National Income and Expenditure Accounts. The projected expenditure estimate is based on the growth in investment in new residential construction obtained from the CEFM.

Rebate to foreign visitors on accommodation

Non-residents visiting Canada are entitled to a rebate for the GST paid on most goods and short-term accommodation. Specifically, the rebate covers the following where the tax paid is at least $20:

- goods for use primarily outside Canada, excluding excisable goods such as alcoholic beverages and tobacco products, provided the goods are exported within 60 days of purchase; and
- the tax paid on short-term lodging, but not including meals, where the period of stay is less than one month.

However, goods for use outside Canada are essentially the same as other exported goods and should be considered as part of the benchmark. Thus, the cost of this provision is only the rebate associated with short-term accommodation.

Revenue Canada has some data related to the cost of the tourist rebate. However, these data are not sufficient to estimate the tax expenditure associated with the tourist rebate. Specifically, it is not possible to identify the value of the rebates that are conferred to businesses that include these rebates as part of their input tax credits.

Rebates for municipalities

Recognized municipalities are entitled to a rebate of 57.14 per cent of the GST paid on their purchases used in the course of supplying exempt municipal services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1996.

Rebates for hospitals

Public hospitals are eligible for a rebate of 83 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1996.

Rebates for schools

Elementary and secondary schools, operating on a not-for-profit basis, are eligible for a rebate of 68 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1996.

Rebates for universities

Recognized degree-granting universities operating on a not-for-profit basis are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1996.

Rebates for colleges

Public colleges which are funded by a government or municipality and whose primary purpose is to provide vocational, technical or general education are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the value of the tax expenditure is influenced by provincial budgetary decisions, the projected value of the tax expenditure for the relevant years is simply the value estimated for 1996.

Rebates for charities

Charities registered under the *Income Tax Act* are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supplies of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the expenditures of charities are captured in Statistics Canada's definition of personal expenditures, the projected estimate is based on the growth in consumer expenditures obtained from the CEFM.

Rebates for non-profit organizations

The organizations eligible for this rebate are government-funded non-profit organizations. They include registered amateur athletic associations and organizations operating a facility or part thereof to provide nursing home intermediate care or residential care, which receive at least 40 per cent of their funding from governments, municipalities or Indian bands. These organizations are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supplies of exempt services.

The estimate for historical years is based on data from Revenue Canada. Since the expenditures of non-profit organizations are captured in Statistics Canada's definition of personal expenditures, the projected estimate is based on the growth in consumer expenditures obtained from the CEFM.

Tax Credits

Special credit for certified institutions

A special credit is provided in the period from January 1, 1991 to the end of 1995 to certified institutions that employ mentally or physically disabled individuals in the manufacturing of goods. These institutions are treated in the same manner as other businesses under the GST. However, they receive a special credit calculated on the basis of 100 per cent of the GST collected from sales on manufactured goods in 1991, 75 per cent in 1992, 50 per cent in 1993 and 25 per cent in both 1994 and 1995.

No data are available.

The GST credit

When the GST was introduced, a GST credit was established to ensure that families with annual incomes below $30,000 would be better off under the new sales tax regime. The amount of the GST credit depends upon family size and income. Currently, the basic adult credit is $199. Families with children 18 years

and younger receive a basic child credit of $105 for each child. However, single parents can claim a full adult credit of $199 for one dependent child. In addition to their basic credit, single adults (including single parents) are eligible for an additional credit of up to $105. The value of the credit is reduced for families with incomes of over $25,921. Both the credit amounts and the income threshold are adjusted annually to increases in the Consumer Price Index in excess of 3 per cent.

The estimate for historical years is based on data from Revenue Canada. The projected expenditure estimate is obtained from the Department of Finance's fiscal forecast.

Memorandum Items

Meals and entertainment expenses

In the normal operation of the GST, registrants are allowed to claim full input tax credits for the tax paid on their purchases. However, in the case of the tax paid on meals, beverages and entertainment expenses, the registrant is allowed to recover only 50 per cent of the GST paid as an input tax credit. (Prior to February 1994, the input tax credit for business meals and expenses was 80 per cent.) There is no input tax credit allowed for the GST paid on membership fees or dues in any club whose main purpose is to provide dining, recreational or sporting facilities.

The estimate is based on the cost of the meals and entertainment tax expenditures contained in the Personal and Corporate Income Tax Expenditure Tables. These figures are first grossed up to arrive at the total meals and entertainment expenses in the entire economy using the marginal federal income tax rates by sector. Then, 15 per cent is removed to account for expenses incurred in GST-exempt activities since they are ineligible for any input tax credits. The cost of this provision is equal to the above net expenses multiplied by 7 per cent.

Rebate to employees and partners

A rebate is available to certain employees of a GST registrant for the GST paid on those expenses that are deductible in computing the employee's income from employment for income tax purposes. For example, an employee is allowed to claim a rebate equal to 7/107ths of the capital cost allowance on an automobile, aircraft or musical instrument that is used in his or her employment and on which GST is payable. Also, the GST rebate is available to an individual who is a member of a GST-registered partnership in respect of expenses incurred outside the partnership that are deducted in computing the member's income from the partnership for the purposes of the *Income Tax Act*.

The estimate for historical years is based on data from Revenue Canada. The projected expenditure estimate is based on the growth in nominal GDP obtained from the CEFM.

Sale of personal-use real property

The sale of personal-use real property by an individual or trust (all of the beneficiaries of which are individuals) is exempt under the GST. Examples include the sale of used owner-occupied homes and country properties kept for personal use. However, the exemption does not include real property that is sold in the course of business.

No data are available.

Chapter 7

Objectives of Tax Expenditures

This chapter is included to respond to the recommendation by the Auditor General in his April 1998 report that the department should identify clear objectives for each tax expenditure and report these objectives in the annual report on tax expenditures.

Personal Income Tax

Culture and Recreation

Deduction for clergy residence

The special treatment of clergy housing expenses recognizes the special nature of the contributions and circumstances of members of the clergy.

- Budget Speech, March 1949.

Flow-through of capital cost allowance (CCA) on Canadian films

To assist the financing and development of the Canadian film industry, the tax law provided until 1995 a special write-off for investment in certain Canadian motion picture films or videotapes certified by the Secretary of State. After 1995, this provision was replaced with a tax credit to producers in order to maximize the benefit to eligible productions.

- Budget Plan, 1995.

Deduction for certain contributions by individuals who have taken vows of perpetual poverty

This measure recognizes the special situation of members of religious orders.

- Section 110(2), *Income Tax Act*, Charitable gifts.

Write-off of Canadian art purchased by unincorporated businesses

The special CCA claim for Canadian art is intended to further the dissemination of Canadian art, as well as to support Canadian artists.

- Budget Papers, 1981.

Assistance for artists

Costs deductible in year incurred

The special treatment of costs incurred by artists recognizes artists' problems in valuing their works of art on hand, attributing costs to particular works, and carrying inventories over long periods of time.

- Budget Papers, 1985.

Charitable gifts from inventory

The special election with respect to a charitable gift from an artist's inventory removes an obstacle to artists donating their works of art to charities, public art galleries and other public institutions.

- Budget Papers, 1985.

Deduction for artists and musicians

The deductibility of certain expenses incurred by artists and musicians recognizes that these expenses are necessary to carry on employment in those fields.

- Musical instruments: Income Tax Reform, 1987.
- Artists' employment expenses: Section 8(1)(q), *Income Tax Act*. Added in 1991, for expenses incurred after 1990.

Non-taxation of capital gains on gifts of cultural property

This provision encourages the donation to designated institutions (such as museums and art galleries) of cultural property determined to be of outstanding significance to Canada's national heritage.

- Budget Plan, 1998.

Education

Tuition fee credit

This measure provides tax relief to students (and their parents) by recognizing the costs of enrolling in qualifying programs or courses.

- Budget Speech, September 1960.

Education credit

This measure provides assistance to students by recognizing non-tuition costs associated with full- and part-time education.

- Budget Supplementary Information, 1972.

Education and tuition fee credits transferred

This measure increases the availability of tax assistance for education, and acknowledges the significant contributions made to students by supporting individuals.

- Income Tax Reform, 1987.

Carry-forward of tuition and education credits

Combined with the provision for transfer of tuition and education credits, this measure ensures that students can use these credits fully, whether they have supporting individuals or not.

- Budget Plan, 1997.

Student loan interest credit

This measure was proposed in the 1998 budget in recognition of the costs of investment in higher education, and to help ease the burden of student loans.

- Budget Plan, 1998.

Exemption on first $500 of scholarship, fellowship and bursary income

This measure provides additional tax assistance to students.

- Summary of 1971 Tax Reform Legislation, 1971.

Deduction of teachers' exchange fund contributions

This measure encourages contact with educators in other Commonwealth countries, thereby expanding the scope of the educational experience of Canadian students, and encouraging the exchange of information on modern teaching methods.

- Budget Speech, 1957.

Registered education savings plans

Tax assistance for education savings plans broadens access to higher education by encouraging Canadians to save towards the post-secondary education of children.

- Budget Plan, 1998.

Employment

Deduction of home relocation loans

This deduction is intended to facilitate labour mobility by allowing employers to compensate relocated employees facing higher housing costs at the new location.

- Budget Papers, 1985.

Non-taxation of allowances to volunteer firefighters

The tax-free allowance for volunteer firefighters acknowledges the importance of these volunteers to small and rural communities.

- Budget Plan, 1998.

Deduction for emergency service volunteers

This measure was proposed in the 1998 budget to further support for small and rural communities, which are often unable to maintain full-time emergency staffs and depend on the services of volunteers.

- Budget Plan, 1998.

Northern residents deductions

These tax preferences assist in drawing skilled labour to northern and isolated communities by providing recognition for the additional costs faced by residents of these areas.

- Budget Papers, 1986.

Overseas employment credit

This measure ensures the competitive international position of Canadian companies undertaking work outside Canada on specified business activities by offering comparable tax treatment as that provided by other countries.

- Budget Papers, 1983.

Employee stock options

This measure encourages employee participation in the ownership of the employer's business, and assists businesses in their efforts to attract and retain highly skilled employees.

- Budget Documents, 1977.

Non-taxation of strike pay

Strike pay is non-taxable by virtue of the Supreme Court of Canada's determination that it is not income from a source.

- *Wally Fries v. The Queen,* (1990) 2 CTC 439, 90 DTC 6662.
- Revenue Canada, IT-334R2 Miscellaneous Receipts.

Deferral of salary through leave of absence/sabbatical plans

This provision recognizes that the main purpose behind these plans is to provide in advance for extended leaves of a sabbatical nature within the employment relationship, and not the deferral of taxes.

- Budget Papers, 1986.

Employee benefit plans

The scope of tax-deferred salary arrangements was significantly reduced in 1986 to improve the fairness of the distribution of tax benefits to individuals in different employment situations. The preferential tax treatment under these

plans is now available only in certain circumstances where an employee's right to income under a plan has not been fully earned, or where the main purpose behind the plan is to provide incentives and not the deferral of tax.

- Budget Papers, 1979.
- Budget Papers, 1986.

Non-taxation of certain non-monetary employment benefits

As noted in the Description of Personal Income Tax Provisions section of the Tax Expenditures report, the taxation of these items would be administratively difficult.

Family

Spousal credit

This credit recognizes that a taxpayer whose spouse has little or no income has a lesser ability to pay tax than a single taxpayer with the same income.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Equivalent-to-spouse credit

This credit recognizes that a taxpayer without a spouse who is supporting a dependent young child, parent or grandparent has a lesser ability to pay tax than a taxpayer with the same income and no such dependant.

- Section 118(1)(b), *Income Tax Act*, Wholly dependent person.

Infirm dependant credit

This credit recognizes that a taxpayer supporting an adult dependant who is physically or mentally infirm has a lesser ability to pay tax than a taxpayer with the same income and no such dependant.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Caregiver credit

This provision was proposed in the 1998 budget to provide additional assistance to individuals providing in-home care for elderly or infirm family members.

- Budget Plan, 1998.

Child tax benefit

The child tax benefit consolidated a number of child-related benefits to provide assistance to low- and middle-income families with children in a simpler, fairer and more responsive manner. It also recognizes the effect of children on the ability to pay tax of middle-income parents.

- Replaced the former refundable child tax credit, family allowance and non-refundable tax credit.
- Budget Papers, 1992.

Deferral of capital gains through transfers to a spouse, spousal trust or family trust

This deferral recognizes that it is not always appropriate to treat a transfer of assets between spouses as a disposition for income tax purposes, and therefore allows families flexibility in structuring their total assets. However, the tax treatment of family trusts was amended in the 1995 budget to ensure that they do not provide undue tax advantages.

- Budget Speech, 1971.
- Budget Plan, 1995.

Farming and Fishing

$500,000 lifetime capital gains exemption for farm property

This measure provides an incentive to invest in the development of productive farms, and allows farm owners to accumulate capital for retirement.

- Budget Papers, 1985.
- The Lifetime Capital Gains Exemption: An Evaluation, Department of Finance, 1995.

Net Income Stabilization Account (NISA)

The NISA program provides an income averaging mechanism for farmers, and reduces the need for other forms of government assistance to the agriculture industry. The tax-deferral component of the program is an integral aspect of this initiative.

- Federal-Provincial Agreement Establishing the Net Income Stabilization Account, 1991.

Deferral of income from destruction of livestock

This deferral was introduced to allow farmers operating on a cash basis adequate time to replace their herds, destroyed under statutory authority, without imposing a tax burden in the year of livestock destruction.

- Budget Papers, 1976.

Deferral of income from grain sold through cash purchase tickets

By permitting the deferral of the reporting of income on grain sales, this measure facilitates the orderly delivery of grain to elevators ensuring that Canada meets its grain export commitments.

- Budget Papers, 1974.

Deferral through 10-year capital gain reserve

This provision, while limiting the tax deferral opportunities, recognizes that where proceeds are receivable over time, fully taxing gains in the year of sale could result in significant liquidity problems for taxpayers. The longer period of deferral for gains on the sale of farm property was introduced to ease the transfer of these assets between family members.

- Explanatory Notes for Act to Amend the *Income Tax Act*, December 1982.

Deferral of capital gain through intergenerational roll-overs of family farms

This measure allows for continuity in the management of family farms in Canada by permitting property used principally in a family farming business to pass from generation to generation on a tax-deferred basis.

- Budget Supplementary Information, 1973.

Exemption from making quarterly tax instalments

This measure ensures consistency in the tax treatment of farmers reporting income on a cash-flow basis.

- Budget Speech, 1943.

Cash basis accounting

This treatment recognizes that requiring all farmers and fishermen to adopt the accrual method of income reporting could result in accounting and liquidity problems.

- Report of the Royal Commission on Taxation, 1966, vol. 4.
- Proposals for Tax Reform, 1969.

Flexibility in inventory accounting

This measure ensures that farmers operating on a cash basis are able to avoid creating losses that would be subject to the time limitation if carried forward.

- From existing description in the Tax Expenditures report.
- Budget Supplementary Information, 1973.

Federal-Provincial Financing Arrangements

Quebec abatement

This provision reflects the election by the Province of Quebec to receive part of the federal program contribution in the form of a tax abatement.

- From the description in the Tax Expenditures report.

- *Federal-Provincial Fiscal Revision Act,* 1964.
- *Federal-Provincial Fiscal Arrangements Act,* Part VI.

Transfer of income tax room to provinces

This provision reflects transfers in 1967 and 1977 by the federal government of tax points to all provinces in place of certain direct cash transfers. The tax point transfer assists provinces in providing services in the areas of post-secondary education, hospital insurance and medicare programs.

- From the description in the Tax Expenditures report.
- *Federal-Provincial Fiscal Arrangements Act,* Part V.

General Business and Investment

$100,000 lifetime capital gains exemption

This exemption was introduced to encourage risk taking and investment. The exemption was eliminated for gains accrued after February 22, 1994 to make the taxation of capital gains fairer, simpler and more sustainable.

- Budget Papers, 1985.
- Tax Reform 1987: The White Paper, 1987.
- Tax Measures: Supplementary Information, 1994.

Partial inclusion of capital gains

The reduced rate of inclusion for capital gains provides incentives to Canadians to save and invest, and to ensure that Canada's treatment of capital gains was broadly comparable to that of other countries. The original inclusion rate of one-half was subsequently raised to two-thirds, and then to its current level of three-quarters, in order to broaden the tax base and increase equity in the tax system.

- Proposals for Tax Reform, 1969.
- Tax Reform 1987: The White Paper, 1987.

Deduction of limited partnership losses

This provision allows for the deductibility of business losses for limited partnerships in a manner consistent with other forms of business organizations.

- Budget Papers, 1986.

Investment tax credits

These incentives were introduced to stimulate investments in productive facilities, and to generate growth and employment in specified regions.

- Budget Supplementary Information, 1975.
- Budget Papers, 1977.
- Budget Papers, 1978.

Deferral through five-year capital gain reserve

This provision, while limiting the tax deferral opportunities, recognizes that where proceeds are receivable over time, fully taxing gains in the year of sale could result in significant liquidity problems for taxpayers.

- Explanatory Notes for Act to Amend the *Income Tax Act*, December 1982.

Deferral through capital gains roll-overs

Roll-over provisions are provided in some situations in which it would not be appropriate to collect a capital gains tax even though the taxpayer has sold or otherwise disposed of an asset at a profit.

- Proposals for Tax Reform, 1969.

Deferral through billed-basis accounting by professionals

This treatment recognizes the inherent difficulty in valuing unbilled time and works in progress.

- Summary of 1971 Tax Reform Legislation, 1971.

Deduction of accelerated tax depreciation

Accelerated rates of capital cost allowance are allowed for various types of property to encourage investment in these assets.

- The Corporate Income Tax System: A Direction for Change, May 1985.

$1,000 capital gains exemption on personal-use property

This exemption was introduced to minimize record keeping and simplify administration with respect to the purchase and disposal of personal-use items.

- Summary of 1971 Tax Reform Legislation, 1971.

$200 capital gains exemption on foreign exchange transactions

This exemption was introduced to minimize record keeping and simplify administration with respect to modest foreign exchange transactions.

- Section 39(2), *Income Tax Act*. This provision is analogous to the exemption on personal-use property.

Taxation of capital gains upon realization

This treatment recognizes that, in many cases, it is difficult to estimate with accuracy the value of unsold assets, and that taxing the accrued gains on assets that have not been sold would be administratively complex and could create significant liquidity problems for taxpayers.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Health

Non-taxation of business-paid health and dental benefits

This provision improves access to supplementary health and dental benefits.

- Budget Plan, 1998.

Disability credit

This credit improves tax fairness by recognizing the effect of a severe and prolonged disability on an individual's ability to pay tax.

- Budget Plan, 1997.

Medical expense credit

This credit recognizes the effect of above-average medical expenses on the ability of an individual to pay tax.

- Budget Speech, 1942.
- Budget Plan, 1997.

Medical expense supplement for earners

This measure improves incentives for disabled Canadians to participate in the labour force by providing an alternative to disability-related supports under provincial social assistance arrangements.

- Budget Plan, 1997.

Income Maintenance and Retirement

Non-taxation of guaranteed income supplement and spouse's allowance benefits

This treatment recognizes that these income-tested payments provide a basic level of support to elderly Canadians with little income other than the old age security pension.

- Budget Speech, 1971.

Non-taxation of social assistance benefits

This treatment recognizes the nature of social assistance as a payment of last resort.

- Budget Papers, 1981.

Non-taxation of workers' compensation benefits

Prior to 1982, workers' compensation payments were excluded from income. Workers' compensation benefits have been non-taxable since the first Boards were established in 1915. The 1981 budget included these payments in income and provided a matching deduction.

- Budget Papers, 1981.

Non-taxation of amounts received as damages in respect of personal injury or death

By exempting from tax funds and annuities resulting from personal injury, this provision recognizes that amounts received as personal injury damages represent to a large extent compensation for a capital loss suffered by the injured taxpayer.

- Budget Supplementary Information, 1972.

Non-taxation of employer-paid premiums for group term life insurance of up to $25,000

This special treatment was removed in the 1994 budget in order to improve fairness in the tax system.

- Tax Measures: Supplementary Information, 1994.

Non-taxation of veterans' allowances, civilian war pensions and allowances, disability pensions and support for dependants

This treatment recognizes that these benefits provide a basic level of support to veterans of Canada's military engagements and their families.

- Budget Speech, 1942.

Treatment of alimony and maintenance payments

The 1996 budget removed this special tax treatment for child support payments made pursuant to an agreement or court order made on or after May 1, 1997 to provide additional support to single parents and families with children.

- Budget Plan, 1996.

Age credit

This provision was introduced to reduce the tax burden borne by elderly Canadians.

- Budget Highlights, 1972.

Pension income credit

This provision was introduced to provide additional protection against inflation for the retirement income of elderly Canadians.

- Budget Speech, November 1974.

Saskatchewan Pension Plan

This measure was introduced to ensure consistency in the tax treatment of Canadians saving for their retirement, whether they save through a private or a provincially sponsored registered plan.

- Budget Papers, 1987.

Registered retirement savings plans/registered pension plans

These measures were introduced to encourage Canadians to save throughout their working lives in order to avoid a serious disruption of their living standards upon retirement.

- Pension Reform: Improvements in Tax Assistance for Retirement Saving, Department of Finance, 1989.

The Home Buyers' Plan

This provision encourages home ownership and activity in the housing market.

- Tax Measures: Supplementary Information, 1994.
- Budget Papers, 1992.

Tax-free RRSP withdrawals for lifelong learning

The 1998 budget proposed this measure to allow Canadians greater access to funds for retraining.

- Budget Plan, 1998.

Deferred profit-sharing plans

This treatment was introduced to allow for additional retirement savings, and to foster co-operation between employers and their workers by encouraging employees to participate in their employer's business.

- Budget Speech, 1960.

Non-taxation of RCMP pensions/compensation in respect of injury, disability or death

This treatment recognizes that these benefits represent to a large extent compensation for a capital loss suffered by members of Canada's national police force, injured in the course of their duties, and their families.

- Section 81(1)(i), *Income Tax Act*.

Non-taxation of up to $10,000 of death benefit

This provision was introduced to alleviate the hardship faced by dependants upon the death of a supporting individual.

- Budget Speech, 1959.

Non-taxation of investment income on life insurance policies

The tax treatment of investment income earned on certain life insurance policies was introduced for reasons of administrative convenience.

- From existing description in the Tax Expenditures report.

Small Business

$500,000 lifetime capital gains exemption for small business shares

This measure was introduced to bolster risk taking and investment in small businesses, allow small business owners to accumulate funds for retirement, and facilitate intergenerational transfers.

- Budget Papers, 1985.
- The Lifetime Capital Gains Exemption: An Evaluation, Department of Finance, 1995.

Deduction of allowable business investment losses

This measure recognizes that small businesses often have difficulty obtaining adequate financing, and provides special assistance for risky investments in such businesses.

- Budget Papers, 1985.

Labour-sponsored venture capital corporations credit

This measure was introduced to encourage investment by individuals in labour-sponsored venture capital organizations, set up to maintain or create jobs and stimulate the economy.

- Budget Papers, 1985.

Deferral through 10-year capital gain reserve

This provision, while limiting the tax deferral opportunities, recognizes that where proceeds are receivable over time, fully taxing gains in the year of sale could result in significant liquidity problems for taxpayers. The longer period of deferral for gains on the sale of small business shares was introduced to ease the transfer of these assets between family members.

- Explanatory Notes for Act to Amend the *Income Tax Act*, December 1982.

Other Items

Non-taxation of capital gains on principal residences

This exemption recognizes that principal homes are generally purchased to provide basic shelter and not as an investment. The exemption also increases flexibility in the housing market by allowing families to more easily move from one principal residence to another in response to their changing circumstances.

- Summary of 1971 Tax Reform Legislation, 1971.
- 1981 budget information kit.

Non-taxation of income from the Office of the Governor General

This exemption recognizes that the income from the Office of the Governor General, who is a direct representative of the Crown, is not subject to tax.

- The exemption was introduced in the 1917 *Income War Tax Act*.

Assistance for prospectors and grubstakers

This treatment was introduced to encourage the development of Canada's natural resources by allowing prospectors and grubstakers to transfer their property claims or interests to a corporation in exchange for shares in that corporation on a tax-deferred basis.

- Budget Supplementary Information, May 1974.

Charitable donations credit

This incentive is designed to support the important work of the charitable sector in meeting the needs of Canadians.

- Introduced in 1930.
- Report of the Royal Commission on Taxation, 1966, vol. 3.
- Budget Plan, 1996, p. 69. Budget Plan, 1997.

Reduced inclusion rate for capital gains arising from certain charitable donations

This measure was introduced to facilitate the transfer of certain publicly traded securities to charities to help them respond to the needs of Canadians, and to provide a level of tax assistance for donations of eligible appreciated capital property that is comparable to that in the United States.

- Budget Plan, 1997.

Gifts to the Crown credit

This measure was introduced to recognize the contributions made by taxpayers to Canadian governments of all levels. The limitation of eligible contributions to 75 per cent of net income allows all charities to attract donations on a level playing field. The measure has evolved from the provision in the 1917 *Income War Tax Act* that permitted the deduction of contributions to the Patriotic and Canadian Red Cross Funds and any other patriotic and war funds approved by the Minister of Finance.

- The *Income War Tax Act,* 1917.
- Report of the Royal Commission on Taxation, 1966, vol. 3.
- Budget Plan, 1997.

Political contribution credit

This provision is intended to ensure that registered political parties, vital to the maintenance of Canada's parliamentary system, have a broad base of financial support.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Non-taxation of income of Indians on reserves

This exemption reflects provisions under section 87 of the *Indian Act.*

- From the description in the Tax Expenditures report.

Non-taxation of gifts and bequests

This exemption recognizes the difficulties associated with the valuation and reporting of the many small gifts of a routine nature exchanged between individuals and families.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Memorandum Items

Non-taxation of lottery and gambling winnings

Proceeds from the sale of lottery tickets are an important source of funds for provincial governments, charities and other not-for-profit organizations. As a result, there is already a considerable element of taxation to lottery and

gambling proceeds. The federal government has vacated this area in favour of the provinces.

- From footnote in 1997 Tax Expenditures report.

Non-taxation of allowances to certain public officials

This provision recognizes the additional costs incurred by certain public officials in the course of their public duties.

- Budget Speech, 1946.

Non-taxation of allowances for diplomats and other government employees posted abroad

This provision recognizes the additional costs incurred by diplomats and other government personnel employed outside Canada.

- Section 6(1)(b)(iii), *Income Tax Act*.

Child care expense deduction

This provision recognizes the costs incurred by single parents and two-earner families in the course of earning business or employment income, pursuing education or performing research.

- Budget Papers, 1992.
- Budget Plan, 1998.

Attendant care expense deduction

This provision recognizes the costs incurred by disabled taxpayers for care by a part-time attendant required to enable the taxpayer to earn business or employment income. In so doing, the provision increases equity between the able-bodied earners and those who incur additional expenses owing to a disability.

- Budget Papers, 1989.

Moving expense deduction

This provision facilitates labour mobility by allowing taxpayers greater flexibility in pursuing new employment and business opportunities anywhere in Canada.

- Budget Speech, 1971.
- Budget Plan, 1998.

Deduction of carrying charges incurred to earn income

This provision recognizes that carrying charges are incurred for the purpose of earning income.

- From description in Tax Expenditures report.

Deduction of meals and entertainment expenses

The partial deduction for these expenses recognizes that, while a portion of these expenditures is incurred in order to earn income and should be deductible, this portion is not clearly separable from the personal component of the expenditures.

- From description in Tax Expenditures report.

Deduction of farm losses for part-time farmers

This provision allows for the limited deductibility of farm losses for part-time farmers to recognize that cash basis accounting can distort the actual financial position of a farming business.

- Sections 31, 111(3), *Income Tax Act*.

Farm and fishing loss carry-overs

These measures provide increased cash flows and reduced risks to farms and fisheries in recognition of the cyclical nature of these industries.

- Budget Papers, 1983.

Capital loss carry-overs/non-capital loss carry-overs

These provisions support businesses and investors by reducing the risk associated with investment and provide tax relief for cyclical businesses.

- Budget Papers: Supplementary Information, 1983.

Logging tax credit

This provision was introduced to reduce double taxation in the forestry industry.

- Budget Speech, 1962.

Deduction of resource-related expenditures

This provision was introduced to encourage the development of Canada's natural resources.

- Budget Speech, 1961.

Deduction of other employment expenses

This provision recognizes that certain expenses must be incurred for the purpose of earning employment income.

- From description in Tax Expenditures report.

Deduction of union and professional dues

This provision recognizes that these payments are of a mandatory nature and therefore incurred to earn income.

- From description in Tax Expenditures report.
- Budget Speech, 1951.

Employment insurance contribution credit/ non-taxation of employer-paid premiums

This provision recognizes that these payments are of a mandatory nature and therefore incurred to earn income.

- From description in Tax Expenditures report.

Canada and Quebec Pension Plan contribution credit/ non-taxation of employer-paid premiums

This provision recognizes that these payments are of a mandatory nature and therefore incurred to earn income.

- From description in Tax Expenditures report.

Foreign tax credit

This provision was introduced to avoid the double taxation of income that has already been taxed in foreign countries.

- From description in Tax Expenditures report.

Dividend gross-up and credit

These provisions contribute to the integration of the corporate and personal income tax systems in order to reduce the double taxation effect of taxing income at both the corporate and personal level.

- From description in Tax Expenditures report.

Supplementary low-income credit

This provision was proposed in the 1998 budget to provide tax relief to low-income Canadians.

- Budget Plan, 1998.

Basic personal credit

This provision contributes to tax fairness by ensuring that no tax is paid on a basic amount of income.

- Report of the Royal Commission on Taxation, 1966, vol. 3.
- Budget Speech, 1998.

Non-taxation of capital dividends

This treatment contributes to the integration of the corporate and personal income tax systems in order to avoid double taxation.

- From description in Tax Expenditures report.

CORPORATE INCOME TAX

Tax Rate Reductions

Low tax rate for small businesses

This lower tax rate is intended to provide small corporations with more after-tax income for reinvestment and expansion.

- Tax Measures: Supplementary Information, February 22, 1994.

Low tax rate for manufacturing and processing

This lower tax rate is intended to enhance the international competitiveness of the manufacturing industry.

- Tax Reform 1987: Income Tax Reform, June 18, 1987.

Low tax rate for credit unions

The purpose of the low tax rate for credit unions is to permit a credit union to accumulate capital on a tax-preferred basis up to a maximum of 5 per cent of deposits and capital.

Exemption from branch tax for transportation, communications, banking and iron ore mining corporations

Exemptions from branch tax are in recognition of the fact that (certain foreign) companies sometimes have no real alternative to the branch office form of organization when operating in other jurisdictions. For example, this is often the case for Canadian mining ventures that are jointly financed by Canadian and foreign interests and require large amounts of capital investment.

- Budget Speech, April 10, 1962.

Exemption from tax for international banking centres

In order to broaden our trade and business interests in Europe and the Pacific Rim, this measure exempts international banking centres established in Montreal and Vancouver. This measure is also intended to return to Canada some banking activities previously conducted abroad and to attract business that normally wouldn’t be conducted in Canada.

- Department of Finance Release 87-16, January 28, 1987.

Tax Credits

SR&ED investment tax credit

The federal income tax incentives for scientific research and experimental development (SR&ED) provide broadly based support for all types of SR&ED performed in every industrial sector in Canada. The rationale for this tax support is that the benefits of SR&ED extend beyond the performers themselves to other firms and sectors of the economy. The existence of these spillovers or externalities mean that, in the absence of government support, firms would likely perform less SR&ED than desirable from the economy's point of view.

Federal tax policy objectives in supporting SR&ED are to:

- encourage SR&ED to be performed in Canada by the private sector through broadly based support;
- assist small businesses to perform SR&ED;
- provide incentives that are, as much as possible, of immediate benefit;
- provide incentives that are as simple to understand and comply with and as certain in application as possible; and
- promote SR&ED that conforms to sound business practices.

Federal income tax incentives for SR&ED assist the private sector in developing new products and processes, improving productivity, enhancing competitiveness and growth, and creating jobs for the benefit of all Canadians.

- Budget Plan, March 6, 1996.

Regional investment tax credits

The three regional investment tax credits are the Atlantic investment tax credit, special investment tax credit and Cape Breton investment tax credit. Regional tax credits are intended to stimulate new incremental investment in these areas.[1]

a) Atlantic investment tax credit

The Atlantic investment tax credit (AITC) was introduced in the March 1977 federal budget. Its objective was to promote economic development (i.e. investment and thereby productivity and employment) in the Atlantic provinces and the Gaspé region. The 1994 budget reduced the rate to 10 per cent.

b) Special investment tax credit

The special investment tax credit (SITC) was introduced in 1980. Its objective was to promote regional development by encouraging foot-loose manufacturing activities to locate within qualifying regions of low growth and high unemployment across Canada. The SITC was eliminated in the 1994 budget, effective January 1, 1995.

c) Cape Breton investment tax credit

In the 1985 budget, the government announced the closure of the heavy water plants in Glace Bay and Port Hawkesbury. However, the government said it would not abandon the people or the region of Cape Breton.[2]

In recognition of the economic situation of Cape Breton Island, the budget announced a new tax initiative to encourage investment on Cape Breton Island. This tax initiative formed a key part of the general adjustment program for this area.[3]

The approach followed in Cape Breton reflected the basic philosophy of this government with respect to the problems of adjustment in both the private and public sectors. To continue supporting non-competitive economic activity drains resources and energy from more productive job-creating activity but adjustment had to take place in a humane way.[4] The credit was terminated after 1992.

- [1] Tax Measures: Supplementary Information, February 22, 1994.
- [2] Budget Speech, May 23, 1985.
- [3] Budget Papers, May 23, 1985.
- [4] Budget Speech, May 23, 1985.

Small business investment tax credit

This tax credit was provided as an incentive for small businesses to accelerate investment spending.

- Economic and Fiscal Statement: Additional Information, December 2, 1992.

Political contribution tax credit

The political contribution tax credit is intended to help ensure that political organizations, so vital to the maintenance of the parliamentary system, have a broad base of financial support.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Canadian film or video production tax credit

The film tax credit is intended to subsidize the Canadian film and video production industry. A refundable tax credit for the production of Canadian films and videos was introduced in 1995 as a replacement for a system of tax shelter deductions for accelerated capital cost allowance. Film financing mechanisms formerly used to provide tax benefits principally to higher-income individuals were replaced by a fully refundable tax credit for eligible films produced by qualified Canadian corporations.

- Budget Speech, February 27, 1995 and Budget Plan, February 27, 1995.

Exemptions and Deductions

Partial inclusion of capital gains

Only part of capital gains are taxed in order to provide incentives to Canadians to save and invest and to put them on roughly the same footing as foreigners investing in Canada.

- A Review of the Taxation of Capital Gains in Canada, November 1980.

Non-deductibility of Crown royalties and mining taxes

Prior to 1974, royalties in respect of the production of natural resources had traditionally been deductible as a business expense.[1] On May 6, 1974, the federal government announced that it would deny the deduction of Crown royalties and provincial mining taxes. This action was taken in order to ensure that provincial royalties, provincial mining taxes and other arrangements having similar effects do not unreasonably erode the corporate income tax base. [2]

Although these payments were made non-deductible, the government introduced a resource tax abatement of 10 percentage points for petroleum profits and 15 percentage points for mining income.

- [1] Budget Speech, November 18, 1974.
- [2] Budget Speech, May 6, 1974.

Resource allowance

The resource allowance was introduced in 1976. It replaced the resource tax abatements noted above. It was viewed as a better way of recognizing that provinces, in one way or another, impose taxes or royalties and to take that fact into account within reasonable limits in determining taxable income.

In addition, the resource allowance was designed to offer more incentives to those who explore and develop in Canada and to impose a greater tax liability on those who do not.

- Budget Speech, June 23, 1975.

Earned depletion

Earned depletion was proposed in the tax reform of 1969 to replace automatic (or percentage/operators) depletion. This latter type of depletion provided a rate reduction of 33⅓ per cent. Automatic depletion was to be phased out by 1976 and depletion earned on expenditures up to 1976 was to be banked for deduction subsequent to 1976.

The earned depletion incentive was designed to encourage taxpayers to undertake more exploration and development than they otherwise would. For certain exploration and development expenditures incurred in the mining and petroleum industries, taxpayers were permitted an earned depletion allowance which, together with other existing write-offs, permitted a total deduction of

133⅓ per cent to 150 per cent of the amounts actually spent. The amount of earned depletion that could be claimed in a year was made subject to a limit of 25 per cent.

In 1974, the phase-in period for earned depletion was shortened. This was because the existing tax incentives were considered to be more generous than was needed to encourage natural resource development.

As part of the government's 1987 tax reform initiative, the ability to earn new earned depletion allowance deductions was phased out by June 30, 1989.

- Proposals for Tax Reform 1969; Budget Speech, May 6, 1974;
  Budget Speech, November 18, 1974; and
  The White Paper, Tax Reform 1987.

Deductibility of charitable donations

Charities play a useful and important role in our national life. Charities are significant in the fields of education, medicine, scientific research, culture, religion and athletics to name just a few major areas. Their role is to fill in gaps of service and financial support where governments should not or cannot play a significant part. To support these charities, the government provides a deduction from income for contributions made by corporations to registered charities.

- Discussion Paper: The Tax Treatment of Charities, June 23, 1975.

Deductibility of gifts to the Crown

Gifts made to Canada or a province are deductible, within certain limits, to encourage such contributions.

Note: The *Income War Tax Act, 1917,* permitted the deduction of contributions to the Patriotic and Canadian Red Cross Funds and any other patriotic fund approved by the Minister.

Interest on small business financing loans

This measure was intended to help small businesses in financial difficulty, including farmers, to obtain loans at lower interest rates.

- Budget 1992: Budget Speech, February 25, 1992.

Non-deductibility of advertising expenses in foreign media

This measure ensures that control of periodicals and newspapers will remain in the hands of Canadians[1] and supports the continued existence of a viable and original Canadian magazine industry. [2]

- [1] House of Commons Debates, vol. 3, 1965.
- [2] Finance Canada News Release 95-050, June 15, 1995.

Non-taxation of provincial assistance for venture investments in small business

Provinces have established venture capital corporations to provide investment capital for small businesses. The non-taxation of provincial assistance for venture investments in small business assists the successful working of such provincial plans.

- Budget Papers, December 11, 1979.

Deferrals

Accelerated write-off of capital assets and resource-related expenditures

Accelerated capital cost allowances are provided for capital assets since faster write-offs are one way in which incentives can be given to investment.[1]

Accelerated capital cost allowances are also provided for certain energy conservation and electrical generating equipment. Initially, this acceleration was provided as a temporary incentive during the mid-1970s in response to the international escalation of oil prices and partly to promote "off-oil" initiatives. An incentive for installation of pollution abatement equipment is also provided to taxpayers at facilities in place before new environmental regulations concerning air and water pollution came into effect in the early 1970s.[2] This incentive remains in place for property acquired until the end of 1998.

In addition, it is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and that the scale of these risks is quite uncertain in most cases. As a result, accelerated write-offs are provided for certain exploration and development expenses so that these costs can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable.[3]

- [1] The Corporate Income Tax System: A Direction for Change, May 1985.
- [2] Tax Measures: Supplementary Information, February 22, 1994.
- [3] Proposals for Tax Reform, 1969.

Allowable business investment losses

Small businesses often have difficulty obtaining adequate financing. The allowable business investment loss rules provide special assistance for risky investments in small business.

- Budget Papers, May 23, 1985.

Holdback on progress payments to contractors

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g., 10 per cent to 15 per cent) is often held back until the entire project is completed satisfactorily. Such holdbacks are considered to become receivable by contractors or payable to subcontractors only upon satisfactory completion of the project. This departure from the accrual method of accounting is provided in order to alleviate potential cash-flow difficulties for this sector.

Available for use

Taxpayers may claim capital cost allowance and tax credits on eligible property at the earlier of the time it is put in use or in the second taxation year following the year of acquisition. Permitting capital cost allowance and tax credits to be claimed in the second taxation year following the year of acquisition even though the property may not have been put into use is intended to reduce the potential impact of the rule upon projects with long construction periods.

- Supplementary Information Relating to Tax Reform Measures, December 16, 1987.

Capital gains taxation on realization basis

Some properties are both unique and infrequently traded, so that it is difficult and expensive to estimate their market value at a particular point in time. Probably the most important and difficult valuation problems are posed by closely held businesses. In addition, taxing changes in the value of assets that have not been sold would in some cases create liquidity problems, for it may be necessary for taxpayers to dispose of part of their assets in order to obtain cash to meet the tax liability. As a result, capital gains are generally taxed on a realization basis rather than as they accrue.

- Report of the Royal Commission on Taxation, 1966, vol. 3.

Expensing of advertising costs

It is often difficult to identify specific costs with specific revenue and, moreover, there is no certainty that any revenue will result from many types of expenditures. As a result, for tax and accounting purposes, it is usual to write off against income most of these expenditures when incurred. Therefore, advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future.

- Report of the Royal Commission on Taxation, 1966, vol. 4.

Deductibility of contributions to mine reclamation and environmental trusts

Contributions to mine reclamation and environmental trusts have been made deductible in order to assist firms that are required to make such contributions. Prior to this change, the mandatory contributions, in combination with previous

income tax rules, led to two problems for companies. First, they could give rise to cash-flow problems and secondly, some companies, particularly single-mine companies, may have been unable to fully utilize the deduction of actual reclamation expenses, since the majority of these expenses occur at the end of the life of the mine, when it no longer produces income.[1]

This measure also assists companies subject to environmental regulations to meet their obligations under the relevant federal or provincial statutes without distorting governments' choices of instrument used to provide assurance that adequate funds are available to conduct restoration activities at the end of operations.[2]

- [1] Tax Measures: Supplementary Information, February 22, 1994.
- [2] Budget Plan, February 18, 1997.

Deductibility of countervailing and anti-dumping duties

The deduction of these duties when paid, rather than waiting to deduct the exact amounts upon final resolution of the dispute, assists firms. This assistance recognizes that these firms are required to pay amounts that are not under the control of the taxpayer and although these amounts may be subsequently refunded, in whole or in part, this process can take several years.

- Budget Plan 1998, February 24, 1998.

Deductibility of earthquake reserves

In 1997, the Office of the Superintendent of Financial Institutions introduced new guidelines that require federally regulated insurance companies selling earthquake protection to meet target levels of preparedness to ensure they have sufficient financial capacity to pay insured earthquake losses when they occur. This measure helps to ensure that sufficient capacity is achieved in a timely fashion.

- Budget Plan 1998, February 24, 1998.

Cash basis accounting

It would create some hardship to require farmers and fishers to adopt the accrual method because of the accounting and liquidity problems which this might involve for those with relatively small incomes. As a result, farming and fishing corporations are permitted to use the cash basis of accounting.

- Report of the Royal Commission on Taxation, 1966, vol. 4.

Flexibility in inventory accounting

For farmers reporting their incomes on a cash basis, the early years of operation can result in heavy start-up expenses with substantial losses. In many cases, the loss cannot be used within the period allowed for the

carry-forward of losses. By permitting farmers to include the value of inventory in income, the amount of reported losses is reduced, thereby overcoming the problem of 'unusable' losses in the early years and allowing those start-up expenses to be taken into account in later, profitable years.

- Supplementary Information on the Budget, February 19, 1973.

Deferral of income from grain sold through cash purchase tickets

By permitting the deferral of the reporting of income on grain sales, this measure facilitates the orderly delivery of grain to elevators ensuring that Canada meets its grain export commitments.

Deferral of income from destruction of livestock

Farmers whose cattle contract one of several contagious diseases can be ordered to destroy some or all of their livestock. These farmers may also be prohibited from housing other animals in the same premises for several months. As most farmers report their income on a cash basis, there could be substantial tax paid by a farmer who is reimbursed for the destruction of an entire herd in one year but is unable to acquire a replacement herd in the same year. This measure allows such farmers to defer taxation on these payments to the year following the year of destruction to permit adequate time to replace their herds.

- Budget Papers: Budget Paper E Supplementary Information, May 25, 1976.

Deferral of tax from use of billed-basis accounting by professionals

Because of the difficulty that professionals have in valuing unbilled time, work in progress need not be brought into income unless the taxpayer chooses to do so.

- Summary of 1971 Tax Reform Legislation.

International

Non-taxation of life insurance companies' world income

To ensure that life insurance companies can compete in foreign markets, foreign income is exempted from tax in Canada. Canadian insurers could not compete in other countries if Canada imposed the normal tax rules on profits earned in a country which taxes on the basis of premiums or investment revenue only.

- Supplementary Budget Papers, March 31, 1977.

Exemptions from non-resident withholding tax

Over time, as the benefits of freer trade in capital, goods, and services have been increasingly recognized, countries including Canada have adjusted their tariff and tax structures to remove impediments to international transactions. Part of this adjustment has been the reduction in non-resident withholding tax on certain payments.

Lower withholding taxes can reduce the cost of Canadian business of accessing capital and other business inputs from abroad. For example, a lower Canadian withholding tax on interest payments to non-residents can reduce the cost of accessing foreign capital in certain situations. Similarly, a reduced withholding tax on royalty payments can reduce the cost of accessing foreign technology and other property and services, and thereby enhance the competitiveness of Canadian businesses requiring these inputs.

- Tax Expenditures, 1997.

Exemption from Canadian income tax of income earned by non-residents from the operation of a ship or aircraft in international traffic

The international shipping tax exemption is a reciprocal tax exemption provided for income earned by a non-resident person in Canada from the operation of a ship or aircraft in international traffic. This exemption, whose purpose is the avoidance of international double taxation, was first introduced in the *Income War Tax Act* earlier this century at a time when Canada had few bilateral double taxation agreements.

Other Tax Expenditures

Transfer of income tax room to provinces in respect of shared programs

One percentage point of corporate tax is transferred to the provinces as part of the federal contribution under the Canada Health and Social Transfer. This transfer assists provinces in providing services in the areas of health, post-secondary education and social assistance.

Interest credited to life insurance policies

This tax expenditure represents the excess of the tax that would have been collected if income of exempt policies were reported on the accrual basis over the 15-per-cent investment income tax collected. Not requiring the reporting of income of exempt policies on the accrual basis reduces complexity for policyholders and insurance companies.

Non-taxation of registered charities and other non-profit organizations

Charities play a useful and important role in our national life. Charities are significant in the fields of education, medicine, scientific research, culture, religion and athletics to name just a few major areas. Their role is to fill in gaps of service and financial support where governments should not or cannot play a significant part. To support these charities, the government exempts registered charities from income tax.

- Discussion Paper: The Tax Treatment of Charities, June 23, 1975.

Income tax exemption for provincial and municipal corporations

Section 125 of the *Constitution Act* states that no lands or property belonging to Canada or any province shall be liable for taxation. This provision means that Crown corporations created at one level of government are exempt from paying taxes imposed by the other level of government, or by governments at the same level. This immunity from taxation extends to all agents of Canada or a province.

- Section 125 of the *Constitution Act*.

Non-taxation of certain federal Crown corporations

Federal Crown corporations that carry on significant commercial activities are subject to federal income tax, which ensures that they compete on a level playing field with similar businesses in the private sector. Other federal Crown corporations are exempt from taxation. Their exempt status avoids the compliance and administration costs associated with filing an income tax return. Furthermore, the net financial position of the federal government would be unchanged if these Crown corporations were required to pay income taxes – the payment of taxes would merely be a transfer of funds from the Crown corporation to consolidated revenues.

Excise tax transportation rebate

The excise tax transportation rebate was designed to provide the transportation industry with immediate cash-flow benefits in exchange for reduced income tax deductions in the future.

- Government of Canada News Release 91-133, December 6, 1991.

Aviation fuel excise tax rebate

The aviation fuel excise tax rebate was designed to provide airlines with an immediate cash-flow benefit in exchange for a reduction in accumulated losses that would otherwise be available to reduce income taxes in future years.

Surtax on the profits of tobacco manufacturers

The surtax on the profits of tobacco manufacturers is intended to maintain federal revenues from the tobacco sector.

- Finance Canada New Releases 96-086, November 28, 1996.

Temporary tax on the capital of large deposit-taking institutions

The temporary tax on the capital of large deposit-taking institutions was adopted to help achieve deficit reduction targets.

- Budget Plan, February 27, 1995.

Memorandum Items

Refundable Part I tax on investment income of private corporations

A refundable Part I tax levied on the investment income of private corporations was intended to reduce the deferral advantage to individuals of earning investment income through these private corporations instead of earning such income directly. The deferral advantage arose when the corporate tax rate applied to this income was lower than the marginal tax rate of the individual shareholder.

- Budget Plan, February 27, 1995.

Refundable capital gains for investment corporations and mutual fund corporations

This item is part of an integrated system of measures that ensures that the treatment of capital gains earned by investment corporations or mutual fund corporations and subsequently distributed is generally comparable to the treatment of capital gains earned directly by an individual. The rationale for this integrated system is that investments made through these kinds of corporations are comparable to investments made by an individual since these special investment corporations must hold only passive investments.

Loss carry-overs

Loss carry-overs are provided to support business operations and investment in a number of ways. Permitting the carry-over of losses provides certainty to firms that they can benefit from tax losses sustained and that they can obtain immediate tax relief by deducting losses against prior years' income thus reducing the risks faced by investors.

- Budget Papers: Supplementary Information and Notice of Ways and Means Motions on the Budget, April 19, 1983.

Deductible meals and entertainment expenses

Business meals and entertainment involve an element of personal consumption and therefore some part of their cost can properly be characterized as a personal expense that should not be deductible. While it is difficult to ascertain what portion of the cost of meals and entertainment represents personal consumption, it is clear that a full deduction of such expenses simply because they are undertaken in the course of business allows the write-off of some part of expenses that are of a personal nature. To reflect the existence of the personal consumption element of these expenses, only 50 per cent of meal and entertainment costs are deductible (80 per cent before March 1, 1994). To the extent that the true personal consumption element is less than 50 per cent, a negative tax expenditure results. To the extent that the personal consumption portion of the cost of meals and entertainment exceeds 50 per cent, a positive tax expenditure results.

- Tax Reform 1987: Income Tax Reform, June 18, 1987.

Large corporations tax – threshold

The objective of the large corporations tax threshold is to ensure that smaller businesses will not be subject to the tax.

- Budget Papers, April 27, 1989.

Large corporations tax – exempt corporations

Because the corporate surtax is creditable against the large corporations tax (LCT) liability, corporations are effectively subject to the greater of the large corporations tax and the corporate surtax. If corporations exempt from paying Part I tax and its related corporate surtax were subject to the LCT, they would have no way of reducing the LCT. As a result, certain corporations such as non-resident investment corporations, deposit insurance corporations and corporations exempt from paying Part I income tax are also exempted from paying the LCT.

Patronage dividend deduction

The purpose of this tax expenditure is to place co-operatives in a position of tax equality with other forms of business enterprise considering that obligated patronage dividend payments reduce the ability to pay tax. To avoid discrimination, similar treatment is provided for patronage dividends distributed by ordinary companies, partnerships or individual business enterprises. If these dividends are considered to be analogous to the payment of a volume discount or the return of excess payments, they would be deductible under the benchmark system and there would not be any tax expenditure. Alternatively, if these payments could be perceived as a distribution of earnings to members, they would not be deductible under the benchmark system.

- Budget Speech, 1946.

Logging tax credit

The logging tax credit was introduced on April 10, 1962 as a means of relieving the tax burden on the forest industry and removing the existing tax discrimination of the forest industry corporations.

- Budget Speech, April 10, 1962.

Deductibility of provincial royalties (joint venture payments) for the Syncrude project (remission order)

The Syncrude project was initiated in the early 1970s when all provincial Crown royalty charges were fully deductible in the computation of income taxes. After a joint venture agreement with the province of Alberta was signed, the project participants received assurances from the federal government that the joint venture payments to the province would be treated as royalties.

In May 1976, the government granted a remission order to Syncrude participants by Order in Council. The remission order permits participants to deduct joint venture payments to Alberta. Income tax regulations provide a resource allowance on the net amount when calculating federal corporate income taxes.

The remission order provides for the deduction of joint venture payments for production from Leases 17 and 22 until the earlier of December 31, 2003 or when cumulative production reaches 2.1 billion barrels.

Deductibility of royalties paid to Indian bands

Royalties paid to Indian bands were deductible prior to the 1974 budget. The government allowed these royalties to continue to be deductible after 1974 to encourage further development of non-renewable natural resources on Indian lands.

Non-resident-owned investment corporation refund

The general rationale for the refund provided to non-resident owned investment corporations is to encourage the investment of foreign funds in Canadian corporations at little tax cost to the government.

- Report of the Royal Commission on Taxation, vol. 4, 1966.

Investment corporation deduction

Investment corporations provide an important flow of individual savings available for investment in the ownership of Canadian industry because qualifying investment corporations must invest in Canadian properties. The purpose of this measure is to induce investment of these savings in Canada rather than abroad.

- Budget Speech, December 20, 1960.

Deferral of capital gains income through various roll-over provisions

Roll-over provisions are provided in some situations in which it would be unfair to collect a capital gains tax even though the taxpayer has sold or otherwise disposed of an asset at a profit.

- Proposals for Tax Reform, 1969.

Deduction for intangible assets

Three-quarters of eligible capital expenditures can be written off at 7 per cent per annum on a declining-balance basis. Prior to 1972, taxpayers could not deduct such expenditures on intangible assets in the year incurred (because they were capital in nature) or over a number of years by way of depreciation (because no asset was acquired on which depreciation could be claimed).

- Summary of 1971 Tax Reform Legislation.

Tax exemption on income of foreign affiliates of Canadian corporations

The Canadian exemption system for taxing the income of foreign affiliates is based on the objective of eliminating double taxation while at the same time encouraging the international competitiveness of Canadian multinationals.

GOODS AND SERVICES TAX

Zero-Rated Goods and Services

Basic groceries

Basic groceries – covering the overwhelming majority of sales of food for preparation and consumption at home – are zero-rated under the goods and services tax/harmonized sales tax (GST/HST). However, soft drinks, confectionery products, snack food and prepared foods are taxable. The zero-rating of basic groceries reflects the widely held view of Canadians that, as a general principle, basic foodstuffs should not be taxed.

- Goods and Services Tax Technical Paper, August 1989.

Prescription drugs

Under the GST/HST, drugs that are prescribed by a physician or dentist are zero-rated. As for basic groceries, this tax treatment is intended to ensure that prescription drugs remain free of tax.

- Goods and Services Tax Technical Paper, August 1989.

Medical devices

A broad range of medical devices that are required to treat or cope with a chronic disease or illness or a physical disability is zero-rated under the GST/HST. This is intended to ensure that these medical devices remain free of tax.

- Goods and Services Tax Technical Paper, August 1989.

Agricultural and fish products and purchases

Many agricultural and fishing products are for human consumption and are therefore zero-rated as basic groceries. In addition, a large range of generally high-cost agricultural and fishing equipment is zero-rated to reduce cash-flow problems for farmers and fishermen.

- Goods and Services Tax Technical Paper, December 1989.

Certain zero-rated purchases made by exporters

Exports are destined for consumption outside Canada and, consequently, are not subject to GST/HST, which is a tax on consumption in Canada. The zero-rating provisions for exports are designed to ensure that goods and services acquired in Canada for export are totally relieved of tax.

- Goods and Services Tax Technical Paper, August 1989.

Zero-rated financial services

Financial services provided to non-residents for use outside Canada are zero-rated, consistent with the tax treatment of other exports. This ensures that Canadian institutions providing financial services remain competitive in global markets.

- Goods and Services Tax Technical Paper, August 1989.

Non-taxable importations

Under the GST/HST, goods imported into Canada are generally taxable. However, the legislation enumerates a short list of goods of different classes – such as basic groceries and prescription drugs – that, upon importation, do not attract the GST/HST. This ensures that imports are treated fairly vis-à-vis domestic-sourced goods that are zero-rated.

- News Release, September 4, 1990.

Tax-Exempt Goods and Services

Residential and other personal-use real property

Generally, the GST/HST applies to residential property when it is first purchased or leased and occupied by an individual. All subsequent sales of used homes are tax exempt. Similarly, residential rents are tax exempt since the tax has been collected from the landlord on or before the time the building was first rented. The exemption for personal-use real property is consistent with the tax treatment of personal property and services not supplied in the course of commercial activities.

The objective of the housing rebates and exemptions for used homes and residential rents is to preserve the affordability of housing while ensuring that the tax regime is not overly complex.

- Goods and Services Tax Technical Paper, August 1989.

Health care services

Basic health care services are generally exempt of GST/HST. This includes most institutional (e.g., nursing home and hospital), professional (e.g., physician, dentist, etc.) and home care.

- Goods and Services Tax Technical Paper, August 1989.

Educational services (tuition)

Basic education is generally exempt of GST/HST. Accordingly, no GST/HST is charged on most courses offered by schools, universities, public colleges and vocational schools.

- Goods and Services Tax Technical Paper, August 1989.

Child and personal care services

Under the GST/HST, no tax is charged on eligible child and personal care services provided to individuals who are underprivileged or suffer from an infirmity or disability.

- Goods and Services Tax Technical Paper, August 1989.

Legal aid services

Sales tax did not apply to legal aid services provided to a province's legal aid society under the former federal sales tax (FST). Under the GST, a province's legal aid society is permitted to elect to treat contracts with private lawyers as taxable. This ensures that legal aid societies are able to obtain the same net benefit that existed under the former FST.

- Goods and Services Tax Technical Paper, December 1989.

Ferry, road and bridge tolls

Ferry, road and bridge tolls are generally exempt of GST/HST. This is consistent with the fact that the use of Canada's highway systems and related infrastructure is not subject to tax.

- Goods and Services Tax Technical Paper, August 1989.

Municipal transit

Like most other supplies by municipalities, municipal transit services are exempt of GST/HST. In most municipalities, these services are financed from general revenues which would not attract sales tax. The government's policy is that, irrespective of how municipal transit services are financed, transit services provided by, or on behalf of, municipalities should be tax exempt.

- Goods and Services Tax Consolidated Explanatory Notes, April 1997.

Exemption for small businesses

Small suppliers, persons whose total taxable supplies in the preceding year are $30,000 or less ($50,000 or less in the case of public sector bodies), are not required to register. Those who choose not to register do not have to charge and remit GST, and they are not entitled to input tax credits. The objective of the small suppliers' threshold is to ensure that very small businesses do not face an excessive administration burden under the GST.

- Goods and Services Tax Technical Paper, August 1989.

Quick method accounting

Registrants using the quick method remit a prescribed percentage of GST collected based on their total tax-included taxable supplies for the period. The objective of the quick method is to simplify the operation of the tax for small businesses.

- Goods and Services Tax Technical Paper, August 1989.

Water and basic garbage collection

Like other standard municipal services, both water and garbage collection are exempt of GST/HST. In most municipalities, these services are financed from general revenues that would not attract sales tax.

- Goods and Services Tax Consolidated Explanatory Notes, April 1997.

Domestic financial services

Although in some cases, the price of a financial service may be easily identified, in many others, the price of a financial service is implicit and difficult to isolate. Therefore, for the sake of consistency and equity, all financial services are exempt under the GST.

- Goods and Services Tax Technical Paper, August 1989.

Certain supplies made by non-profit organizations

Public sector bodies, which include charities and non-profit organizations, are organizations that perform essentially a public service function, relying heavily on financial support from governments and the voluntary efforts and contributions of the general public to pursue their efforts. The exemption of supplies made by non-profit organizations recognizes the important role they play in Canadian society.

- Goods and Services Tax Technical Paper, December 1989.

Tax Rebates

Rebate for book purchases made by qualifying institutions

The 100-per-cent GST rebate on books is available to public libraries, schools, universities, colleges, municipalities, and qualifying charities and non-profit organizations. The special rebate recognizes the important role played by public libraries, educational institutions and other groups in improving literacy levels in their communities.

- News Release, October 23, 1996.

Housing rebate

The GST new housing rebate program was designed to ensure that the GST does not pose a barrier to the affordability of new homes. Before the GST was introduced, the federal sales tax component of the total price of a new home amounted to approximately 4.1 per cent. With the GST new housing rebate, new homes are taxed at roughly the same level as they were prior to the GST.

- Goods and Services Tax Consolidated Explanatory Notes, April 1997.

Rebate to foreign visitors on accommodation

The Visitors' Rebate Program provides a rebate to non-residents visiting Canada for GST paid on most goods and short-term accommodation. It also provides rebates for conference-related expenses for conferences attended by non-residents. Its objective is to maintain the attractiveness of Canada as a destination for foreign tourists and conventions.

- Goods and Services Tax Technical Paper, December 1989.
- Press Releases, December 18, 1990 and May 15, 1991.

Rebates for municipalities, universities and colleges, schools, and hospitals

Since municipalities, universities and colleges, schools and hospitals (MUSH) provide primarily tax-exempt services, they are unable to claim input tax credits for GST paid on most of their purchases. However, these organizations are entitled to partial GST rebates of 57.14 per cent, 67 per cent, 68 per cent and 83 per cent, respectively.

The MUSH rebate system was established to ensure that the sales tax burden of these entities did not increase as a result of moving to the GST from the previous federal sales tax.

- Goods and Services Tax Technical Paper, August 1989.

Rebate for charities and non-profit organizations

Under the GST, registered charities are eligible to claim a 50-per-cent rebate of the non-creditable GST paid on purchases relating to their non-commercial activities. Other non-profit organizations may also claim the rebate, provided they receive at least 40 per cent of their funding from government. The objective of the rebate is to effectively reduce GST costs for these groups, in recognition of the important role they play in Canadian society.

- Goods and Services Tax Technical Paper, December 1989.

Tax Credits

Special credit for certified institutions

Under the former federal sales tax (FST), certain organizations certified by Revenue Canada that employed people with mental or physical disabilities were exempt from paying or charging sales tax on materials and manufactured goods, respectively. Under the goods and services tax (GST), a transitional GST credit was introduced to allow certified institutions time to adapt to the new GST environment. Under the transitional measure, certified institutions were to retain a proportion of the tax collected on their sales. The deductible portion was 100 per cent for 1991, 75 per cent for 1992, 50 per cent for 1993, and 25 per cent for 1994 and 1995, the last year of the transitional program.

- Goods and Services Tax Consolidated Explanatory Notes, April 1997.

The GST credit

The refundable GST low-income credit was established to replace the former sales tax credit in place under the previous federal sales tax and to offset the impact of the GST. At the time of the introduction of the GST, the credit was enhanced for single parents and single individuals and the threshold at which benefits begin to be reduced was increased. The objective of the credit is to improve the fairness of the sales tax system.

- Goods and Services Tax Technical Paper, August 1989.

Memorandum Items

Rebate to employees and partners

Many employees and partners who are not registrants incur expenses in the course of carrying out their duties that may not be directly reimbursed by their employers and partnerships. Instead, compensation is usually provided through salaries, commissions, profits and other means that would not be subject to tax. Consequently, employers and partnerships cannot recover the GST paid by the employees and partners.

The employee and partner rebates recognize these existing business practices and attempt to reduce the possible tax cascading effect that otherwise would occur in the absence of the rebates.

- Goods and Services Tax Technical Paper, August 1989.